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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 1180

HUNTINGTON TRUST & SAVINGS BANK,
a corporation,

Petitioner,

vs.

H. B. AGSTEN & SONS, INC.,
a corporation,
BERNARD L. BOUTIN, ADMINISTRATOR,
SMALL BUSINESS ADMINISTRATION, and
ODUS R. KINCAID and DELBERT E. WILLIAMS,
TRUSTEES,
WILLIAM H. MEINERS, d.b.a. GENERAL
FLOOR COMPANY,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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Petitioners pray that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on the 4th day of December, 1967.

Opinions Below

The United States District Court for the Southern District of West Virginia rendered no written opinion, but entered an order approving and confirming the report of George S. Wallace, Jr., special master to whom

the cause had been referred. The report of said special master is reproduced in the appendix to this petition. The opinion of the Court of Appeals has not yet been reported, but, together with the concurring and dissenting opinions, is reproduced in the appendix to this petition.

Jurisdiction

The judgment of the Court of Appeals was entered on December 4, 1967. It is believed that this Court has jurisdiction to review the judgment herein by Writ of Certiorari under 28 U.S.C. § 1254 (1).

Questions Presented

This case presents an issue as to the proper distribution of the proceeds from a judicial sale of real estate of an insolvent debtor as between three of its largest creditors: a contractor holding a mechanic's lien; a bank holding a deed of trust lien; and The Small Business Administration, an agency of the United States, also holding a deed of trust lien but claiming priority under the Federal Insolvency Statute, R. S. § 3466, 31 U.S.C. § 191. Under state law, the contractor's claim being prior in time, is superior to the claims of the bank and the SBA, and the bank's claim is likewise superior to the SBA, both in point of time and by specific agreement. Under federal law, the Federal Agency's claim is superior to the claim of the contractor, but by specific agreement is subordinate to the bank's claim. The questions presented are:

1. Does the Federal Insolvency Statute, R. S. § 3466, 31 U.S.C. 191, accord to debts due the United States absolute priority for payment out of the assets of an insolvent debtor irrespective of the existence of competing, specific, perfected and fully choate liens?

2. If so, does an agreement, made by The Small Business Administration, in furtherance of the purpose of the Small Business Act, to subordinate a lien securing a loan made by the SBA to a lien securing a loan made by a private bank, extend to such bank the benefit of the overriding priority accorded debts due to the United States under the Federal Insolvency Statute, R.S. § 3466, 31 U.S.C. 191?

3. If the Federal Insolvency Statute, R.S. § 3466, 31 U.S.C. 191, does not accord absolute priority to debts due the United States as against specific, perfected or choate liens, is the overriding priority of the Federal Insolvency Statute to be applied before or after the relative priorities of competing liens have been determined under state law?

4. If the bank's claim is entitled to priority over debts due the United States because of either an exception to or waiver of the priority created by R.S. § 3466, may the bank be required to satisfy in full out its recovery, a claim secured by a mechanic's lien which is inferior to debts due the United States?

Statutes Involved

The pertinent statutes are reproduced in the appendix to this petition.

Statement of the Case

West Virginia Industries Development Corporation, a West Virginia corporation, hereinafter called West Virginia, was the owner of thirty-one acres of land in Point Pleasant, West Virginia. After obtaining, on May 11, 1964, from the Area Redevelopment Administration, an authoriaztion for a loan to be made by The Small Business Administration, hereinafter

called SBA, in the sum of $1,042,500.00, it entered into a contract with H. B. Agsten and Sons, Inc., hereinafter called Agsten, for the construction on said land of a large motel. One of the conditions of said loan authoriaztion was that West Virginia should obtain an additional loan of funds from a non-governmental lender in the sum of $400,000.00, to be disbursed prior to or concurently with the SBA loan, which was to be subordinated to it. Although it was originally understood that the $400,00.00 loan would be made by Walston and Company, that loan did not materialize and the funds were eventually obtained on the same terms from Huntington Trust and Savings Bank, hereinafter called the Bank.

Construction of the motel was begun by Agsten on May 29, 1964. On September 22, 1964, West Virginia executed and delivered to the Bank a promissory note payable upon demand in the sum of $400,000.00 bearing six percent (6%) interest and secured the same by a deed of trust creating a lien upon the thirty-one acre tract, which deed of trust was the same day duly filed for record in the County Clerk's Office in accordance with state law.

On October 29, 1964, the SBA loan was carried into effect by the execution and delivery of West Virginia's promissory note in the sum of $1,042,500.00 bearing interest at the rate of four percent (4%) per annum, payable to SBA in installments, and secured by a deed of trust creating a lien upon said thirty-one acre tract of land, which deed of trust was duly recorded in the County Clerk's Office on October 30, 1964, in accordance with state law. This deed of trust contained a provision by which the same was made subject to and subordinate to a prior deed of trust securing a loan in the amount of $400,000.00. (The special master found

that this provision refers specifically to the Bank's $400,000.00 loan and this finding is not in dispute.) Thereafter, as construction proceeded, the Bank's loan was disbursed concurrently with the SBA loan on a pro rata basis in accordance with the ARA Loan Authoriatizon.

The motel was substantially completed in June, 1965, at which time West Virginia was insolvent. On August 30, 1965, Agsten filed in the County Clerk's Office a notice of mechanic's lien claiming a balance of $217,000.00 due on its contract and afterwards instituted this action in the Circuit Court of Mason County, West Virginia, to enforce its lien, naming as defendants West Virginia and all lien holders, including SBA and the Bank. SBA caused the action to be removed to the United States District Court for the Southern District of West Virginia which had jurisdiction because the United States was a party.

The special master, to whom the cause was referred, after finding that West Virginia was insolvent and in default in the payment of its indebtedness, determined the priorities for payment of claims against the real estate as follows:

> It is the opinion of the Special Master that the claim of Huntington Trust & Savings Bank of Huntington, West Virginia, in the amount of $412,607.00, with interest in the amount of $8,114.62 calculated to March 28, 1966, with additional interest in the amount of $68.78 per day until satisfied, shall be next after the payment of court costs and real estate taxes. However, out of this sum due the Bank shall be paid the amount due the Contractor, H. B. Agsten & Sons, Inc., P. O. Box 2707, Charleston, West Virginia, in the amount of $217,098.33, with interest in the amount of $8,445.17 calculated to

March 10, 1966, plus interest on the principal amount of $35,687 per day until satisfied.

The special master then found that next in priority was the indebtedness due SBA.

There are numerous other liens involved in this proceeding, but as they are all inferior to the liens of Agsten, the Bank and SBA, with the exception of certain mechanic's liens which are included in Agsten's claim, it is unnecessary to give further consideration to them.

The District Court approved and confirmed the findings of the special master and ordered the real estate of West Virginia to be sold. It was afterwards sold for the sum of $700,000 to SBA.

The effect of the priorities as established by the special master was to allow Agsten payment of its entire claim, the Bank less than one-half of its claim, with the SBA receiving the balance.

The Bank objects to the special master's findings establishing the priorities for payment as between Agsten, the Bank and SBA.

Reasons for Granting the Writ

1. This case presents an important question of federal law which this Court has never decided and which should be decided in this case. That question is whether the Federal Insolvency Statute, R.S. § 3466, 31 U.S.C. 191, creates an absolute priority for the satisfaction of debts due the United States from an insolvent debtor paramount to perfected, specific and choate liens on the debtor's property.

In the early decisions of *Thelusson* v. *Swift*, 2 Wheat 396, 426, 4 L.Ed. 271; *Conard* v. *Atlantic In-*

surance Company, 1 Pet. 386, 7 L.Ed. 189; and *Brent* v. *Bank of Washington,* 10 Pet. 596, 611, 612, 9 L.Ed. 547, an exception was read into the statute in the case of previously executed mortgages on the theory that mortgaged property is no longer part of the debtor's estate. Later decisions have by implication questioned the soundness of those early decisions. See *U.S.* v. *Texas,* 314 U.S. 480, 488, 62 S.Ct. 350, 354, 86 L.Ed. 356; *New York* v. *Maclay,* 288 U.S. 290, 53 S.Ct. 323, 72 L.Ed. 754. In any event, the Court has repeatedly said that the question of whether the priority of the United States under R.S. § 3466 would be defeated by a specific and perfected lien upon property where title and possession remain in the debtor has never been decided. In view of the fact that under West Virginia law, a deed of trust does not divest the debtor of title or possession, but creates a lien only, the question is here directly presented.

The resolution of this question is of vital importance to the effective administration of the Small Business Act, 15 U.S.C. §§ 631-651 which has as its purpose the encouragement and development of small business by the granting of federal loans and other assistance.

The Small Business Act contemplates the making of loans by banks and other non-governmental lending institutions in conjunction with loans to be made by the SBA, and its provisions evidence a purpose to stimulate, rather than to inhibit, the making of such private loans. The bank's loan in this case was made in conjunction with the SBA loan and, by agreement, the SBA loan was to be subordinate to it, both loans being made in furtherance of the purposes of the Small Business Act.

Congress, in enacting the Small Business Act, must have been aware that loans made by the SBA would

create debts due the United States and that in the event of the debtor's insolvency, R.S. § 3466, requires that such debts be first satisfied. Nothing in the Small Business Act indicates that Congress intended to except such debts from the operation of the Federal Insolvency Statute.

If a specific and choate lien will not defeat the priority accorded the SBA by R.S. § 3466, then as pointed out by Judge Bryan in his dissent from the opinion of the Court of Appeals, the making of a loan by SBA would immediately jeopardize and, in the event of the debtor's insolvency, completely destroy the security of every private lender. No private lender could ever be safe in such circumstances. To induce private banks to make such loans the SBA must place the bank in a position of priority. The Court of Appeals has held that the Bank is prior to SBA but not prior to Agsten. *Quaere*: Does the bank's priority rest upon federal law or state law? It is no answer to say that federal law gives the bank priority over SBA but state law takes it away since it is only by virtue of SBA's assertion of a federal law priority that the bank's recovery is put in jeopardy.

2. It is therefore also a matter of importance in the administration of the Small Business Act whether an agreement on the part of SBA to subordinate its position in favor of a private bank as an inducement for such private bank to make a loan to a small business is an extension of SBA's overriding priority to such private bank. And where such extension is effected, may the benefit thereof accrue to other private creditors who, under state law, enjoy a priority over such bank?

This matter was touched upon by this Court in

SBA v. *McClellan,* 364 U.S. 446, 81 S. Ct. 191, 5 L.Ed. 2d 200. In that case the SBA and the Bank made a joint loan, each putting up part of the loan funds, but the loan was made in the name of the Bank. After the debtor had been adjudicated a bankrupt, the bank assigned the loan to the SBA which agreed to pay over to the bank one-fourth of all amounts recovered. The Courts held:

> The SBA was authorized to enter into contracts calculated to induce private banks to make loans to small businesses. The contract involved in this case, by providing additional security to the private bank at the government's expense, is well adapted to that end.

The facts in this case are different in that the Bank and the SBA made separate loans but the SBA loan was expressly subordinated to the Bank's loan for the purpose of providing additional security to the Bank. The subordination agreement was an inducement for the Bank to make the loan and, it is therefore, in principle, not unlike the *McClellan* case. Although couched in terms of subordinating a lien in favor of a lien the subordination would be a meaningless gesture and a fraud upon the Bank unless it were held to be an extension of SBA's overriding priority under R.S. § 3466, otherwise, the assertion of that priority by SBA not only defeats the purpose of the subordination agreement, but penalizes the Bank for having dealt with SBA.

The Court of Appeals took the position that although such subordination is effective to give the Bank priority over SBA, federal law is not concerned with the ultimate disposition of the funds, that being a matter of state law.

The Court then held that state law requires the application of these funds first to the satisfaction of the claim of Agsten whose mechanic's lien under state law is prior to the Bank's deed of trust lien. As thus applied, state law is allowed to control and defeat an agreement made under the authority and in furtherance of the purposes of federal law, to wit, the Small Business Act. As a direct result of such holding, Agsten's claim, which enjoys no priority over SBA, is satisfied in full by the operation of state law, while the claim of the Bank, which was induced to make the loan on the strength of the priority extended to it under federal law, remains unsatisfied. The long range effect of this decision will be to handicap SBA in its efforts to induce private banks to make small business loans, and thwart the will of Congress.

3. The Court of Appeals failed correctly to distinguish between the priority arising from a lien and the priority created by the Federal Insolvency Statute. It treats R.S. § 3466 as if its sole purpose and effect is to convert SBA's inferior trust deed lien into a first lien. It therefore incorrectly treats the issue here presented as a circuity of liens caused by competing state and federal statutes, which is not the case at all. The only liens to be considered are: (1) Agsten's mechanic's lien; (2) the Bank's trust deed lien; and (3) SBA's trust deed lien. No federal lien statute is involved and as state law clearly establishes priorities as between the liens in the order listed above, no circuity of liens exists. The Federal Insolvency Statute injects an entirely different factor, which is not a lien but an overriding priority for satisfaction of debts due the United States irrespective of liens. The Federal Insolvency Statute does not create a lien; nor does it elevate an inferior lien securing debts due the United States to a position

of priority. It elevates the debt itself to a position of priority. *U.S.* v. *City of New Britain,* 347 U.S. 81, 74 S. Ct. 367, 98 L.Ed. 520. It is important that this distinction be made clear so that the proper relationship of federal and state law may be maintained. It is equally important that some rule be formulated as to the order of applying federal and state law where the results may differ, depending on which is first applied.

The Court of Appeals, following what is termed the "Federal Policy," i.e., that federal law determines the ultimate priorities of conflicting claims where a federal agency is involved, first applied the federal law and determined that SBA is superior to Agsten but inferior to the Bank. It then applied state law and determined that Agsten's claim is to be first satisfied out of the Bank's recovery. This solution fails to give the fullest effect to either federal or state law. It allows a claim, admittedly inferior to the federal claim, to be first satisfied contrary to federal law. It allows state law to override federal law by denying to the Bank the benefit of a priority accorded to it by federal law.

Since no federal lien is involved, it would seem the better reasoning to determine the priority as between the competing liens on the basis of state law without regard to federal law, and then apply the overriding priority of the Federal Insolvency Statute as against every claim which cannot withstand it. Thus, Agsten's claim would be entitled to a first lien priority under state law, but being unable to prevail against the Federal Insolvency Statute, the amount of Agsten's claim would have to be paid to the SBA. This would result, not from any failure to give effect to state lien

priorities, but solely from the superior force of federal law.

The Bank's claim should then be allowed a second lien priority under state law, subject also to SBA's overriding priority, but because SBA has expressly subordinated its position to that of the Bank, the Bank's claim must prevail against SBA and be satisfied in full.

This presents no conflict between state and federal law, but permits state law to operate within its proper sphere while giving full effect to the constitutional supremacy of federal law.

CONCLUSION

For the reasons stated, it is respectfully submitted that a Writ of Certiorari should be granted.

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Attorneys for Petitioner

APPENDIX

REPORT OF GEORGE S. WALLACE, JR. SPECIAL MASTER

APPEARANCES

For on behalf of parties to suit:

Mr. Hubard Ky Kloster meyer and Mr. William B. Maxwell, Attorneys for H. B. Agsten & Sons, Inc., Plaintiff.

Mr. Sidney S. McNeer, Jr., Attorney for the defendants Huntington Trust and Savings Bank, A. Grant Beckett, Trustee, and W. Kennon Cowden, Trustee.

Mr. W. Kennon Cowden, Trustee, in person.

Mr. George P. Beier, Assistant United States Attorney, appearing on behalf of the defendant Small Business Administration.

Mr. Julius R. Kincaid, Trustee, Small Business Administration, in person.

Mr. Edwin Slipek, Regional Counsel, Small Business Administration, Richmond, Virginia.

Mr. Edmund Hooker, Chief, Liquidation Division, Small Business Administration, Richmond, Virginia.

Mr. Guy Morris, Regional Director, Small Business Administration, Clarksburg, West Virginia.

Mr. Raymond G. Musgrave, Attorney for the defendant Carolina Lumber and Supply Company.

Mr. Paul M. Friedberg, Attorney for the defendant B & B Furniture Company.

Mr. H. L. Ducker, Attorney for the defendant Minter Homes Corporation.

Mr. Frank L. Taylor, Jr., Attorney for the defendant Andersons' Black Rock, Inc.

APPENDIX

REPORT OF GEORGE S. WALLACE, JR. SPECIAL MASTER.

APPEARANCES
(on behalf of parties to suit)

Mr. Howard K. Klostermeyer and Mr. William B. Maxwell, Attorneys for H. B. Agsten & Sons, Inc., Plaintiff.

Mr. Selden S. McNeer, Jr., Attorney for the defendants Huntington Trust and Savings Bank, A. Grant Beckett, Trustee, and W. Kennon Cowden, Trustee.

Mr. W. Kennon Cowden, Trustee, in person.

Mr. George D. Beter, Assistant United States Attorney, appearing on behalf of the defendant Small Business Administration.

Mr. Odus R. Kincaid, Trustee, Small Business Administration, in person.

Mr. Edwin Slipek, Regional Counsel, Small Business Administration, Richmond, Virginia.

Mr. Edmund Hooker, Chief, Liquidation Division, Small Business Administration, Richmond, Virginia.

Mr. Guy Morris, Regional Director, Small Business Administration, Clarksburg, West Virginia.

Mr. Raymond G. Musgrave, Attorney for the defendant Carolina Lumber and Supply Company.

Mr. Paul M. Friedberg, Attorney for the defendant B & L Furniture Company.

Mr. H. L. Ducker, Attorney for the defendant Minter [illegible] Corporation.

Mr. Frank L. Taylor, Jr., Attorney for the defendant [illegible]ndersons' Black-Rock, Inc.

Report of George S. Wallace, Jr., Etc.

APPEARANCES

(on behalf of those not parties to suit)

Dean & Smith, Attorneys at Law, by Mr. Cecil B. Dean.

Mr. William McDavid, on behalf of Arbuckle Store.

Mr. Edward H. Greene, Attorney for Rolph Lee and L. A. Wright.

Mr. Luther Miller, representing himself pertaining to wages.

Mr. Ralph Shannon, representing himself.

Cruse Music Company (represntative's name not ascertainable from record).

Mr. Don Carey, representing Bar-Master and First National Bank of Ronceverte.

Mr. I. M. Herbert, representing Reeves Broadcasting Corporation.

Mr. Raymond G. Musgrave, Attorney for Lonnie Safford, d.b.a. Safford Studios, and Attorney for Hamilton Provision Company, and Standard Food Service.

To the Honorable Sidney L. Christie,
Judge of said Court:

By order entered on the 5th day of March, 1966, the above styled action was referred to the undersigned as special master to hear the parties and take testimony with respect to the issues formed by the pleadings herein and to report his findings of fact and conclusions of law and to take and state on account and report upon the following matters:

1. The real estate which is subject to the contractor's lien set forth in the complaint herein, and the quantity, description and location thereof.

2. The names and addresses and the estates of the owner or owners of said real estate.

3. All of the liens on said real estate and the names and addresses of the respective owners of said liens, the amount due to each, and the respective priorities thereof.

4. All other matters pertinent to this cause which the special master may be requested in writing by any party to this action to ascertain or which the special master may deem pertinent.

Pursuant to the directions in said order, the undersigned gave notice as was required by law and by the order of reference to all of the parties in the suit, showing the time, place and purpose of the hearing herein and also by publishing such notice in The Register, a newspaper printed and published in Mason County, West Virginia, one time a week for three successive weeks, to-wit, on March 11, 18, and 25, 1966, a verified certificate of the publisher of said newspaper showing such publication being hereto attached and made a part hereof.

Upon the return day of the notice, to-wit, the 28th day of March 1966, the parties appeared at the office of the undersigned special master in Suite 200, Chafin Building, 517 Ninth Street, Huntington, West Virginia, from whence, due to the number of parties who appeared, the proceedings were moved to Room 203 in the Post Office Building in the City of Huntington. The proceedings thenceforward were regularly adjourned from time to time until they were finally completed.

Glen K. Matthews and Mary Beth Gudykunst, two shorthand reporters, were first duly sworn to take

down the testimony in shorthand characters and thereafter to transcribe the same into the English language, each to the best of their skill and ability.

The special master fully examined the witnesses as produced by the parties touching the matters of inquiry before him and caused the examination to be reduced to writing in the form of depositions, which are herewith returned and made a part of this report. He also examined the documentary proofs, which are likewise herewith returned. Upon due consideration of which, the undersigned special master submits his report as follows:

In order that the findings of the special master may not become too burdensome and in order that the various parties to this litigation may be easily identified, the parties most frequently referred to will be designated as follows:

H. B. Agsten & Sons, Inc.	Contractor
West Virginia Industries Development Corporation	Defendant
Small Business Administration	S.B.A.
Huntington Trust and Savings Bank	Bank
Internal Revenue Service	IRS

(A)

THE REAL ESTATE WHICH IS SUBJECT TO THE CONTRACTOR'S LIEN SET FORTH IN THE PLAINT HEREIN (AND ALL OTHER LIENS) AND THE QUANTITY, DESCRIPTION, AND LOCATION THEREOF.

THE NAMES AND ADDRESSES AND THE ESTATES OF THE OWNER OR OWNERS OF SAID REAL ESTATE.

The first and second requirements, since they are interrelated, are consolidated.

The special master finds that the defendant West Virginia Industries Development Corporation, whose address is Point Pleasant, West Virginia, is the owner in fee of that certain tract or parcel or real estate situated in Robinson District, Mason County, West Virginia, more particularly bounded and described as follows:

> Beginning at the intersection of the new northerly line of the Old Town Road and the easterly line of West Virginia State Highway Route No. 62 and running thence northerly along the said easterly line of Route No. 62, 1840.0 feet to a point; thence S. 54° 50′ E. 760.0 feet to a point; thence South 21° 43′ W. 1550.0 feet, more or less, to the new northerly line of Old Town Road aforesaid; thence North 76° 32′ W. along the said new northerly line of Old Town Road 800.0 feet, more or less, to where the same intersects the aforesaid westerly line of State Highway Route No. 62 and the point or place of beginning, containing 31 acres, more or less, and being a portion of the land acquired from G. G. P. Musgrave as part of the West Virginia Ordnance Works.
>
> Together with the right to use, operate, and maintain that portion of the outfall sewer known as the Old Camp Conley sewer, extending from Camp Conley a distance of approximately 393

feet westwardly across government owned land to the western perimeter of the West Virginia Ordnance works as said sewer is now located.

Being the same real estate conveyed to the Defendant by Isabelle Wright and L. A. Wright, her husband, and Rolfe Lee and Violet Lee, his wife, by deed dated October 9, 1961, and of record in the office of the Clerk of the County Court of Mason County, West Virginia, in Deed Book 184 at page 431.

(B)

Third Requirement

ALL OF THE LIENS ON SAID REAL ESTATE AND THE NAMES AND ADDRESSES OF THE RESPECTIVE OWNERS OF SAID LIENS, THE AMOUNT DUE TO EACH, AND THE RESPECTIVE PRIORITIES THEREOF.

In order to ascertain the proper priorities of liens against the real estate of the Defendant, which is set out under the First Requirement, it is necessary to reconcile both the Federal and State laws applicable to this case. Because of the priority granted to the United States Government by statute in the event of the insolvency of a debtor, before any priorities can be established it is first necessary to determine the solvency of the Defendant.

I.

SOLVENCY OF DEFENDANT.

The attorney for the S.B.A. introduced two wit-

nesses who testified in regard to the solvency of the Defendant.

Mr. Reuben B. Parran (Record, pp. 120-124), an auditor for the Economic Development Administration, Department of Commerce, testified that he made a normal financial audit at the request of the S.B.A. of the books of the Defendant. Mr. Parran testified that in his opinion, after making this audit, the Defendant was insolvent as of November 30, 1965.

Mr. Charles Forsythe, an attorney in the Regional Office of the SBA at Clarksburg, West Virginia, testified (Record, pp. 125-130) that he made an examination of the Judgment Lien Docket in the office of the Clerk of the County Court of Mason County, West Virginia, to ascertain judgments of record against the Defendant.

Mr. Forsythe testified that as a result of his examination he found the following abstracts of judgment against the Defendant, none of which appeared satisfied of record:

10/28/65	Standard Food Service, Inc. . . .	$ 2,178.32	
	Costs . . .	20.00	$ 2,198.32
1/ 3/66	William Iselin and Company, Inc,, assignee of Turner Manufacturing Company . . .	3,860.55	
	Costs . . .	20.75	3,881.30

12/31/65	Hamilton Provision Company . . .	5,580.37	
	Costs . . .	20.00	5,600.37
12/31/65	Lonnie Safford, d.b.a. Lonnie's Professional Photography . . .	680.80	
	Costs . . .	20.00	700.80
1/ 7/66	Carolina Lumber Company . . .	1,068.86	
	Costs . . .	20.00	1,088.86
2/25/66	Kroehler Manufacturing Company	45,332.43	
	Costs . . .	20.00	45,352.43
2/18/66	B & L Furniture Company . . .	59,143.75	
	Costs . . .	10.75	59,154.50
2/18/66	National Pool Equipment Company, Inc.	17,946.54	
	Costs . . .	10.75	17,957.29

There was no denial of the testimony of either Mr. Parran or Mr. Forsythe.

The special master finds the evidence and the testimony that the Defendant is insolvent, and the apparent failure to satisfy the judgments enumerated in the tes-

timony of Mr. Forsythe constitutes an act of bankruptcy as contemplated in Title 31, U.S.C. Section 191.

In the case of Jones, et al. v. Foodco Realty, Inc., et al., 318 Fed. (2) 881 the court held:

> "The debtor's failure to vacate or discharge a judgment lien was an 'act of bankruptcy' as defined by the Bankruptcy Act and debtor whose debts exceeded value of its assets was 'insolvent' within the statute providing that where any person indebted to the United States is insolvent, debts due the United States shall first be satisfied. (Title 31 U.S.C. 191; 11 U.S.C. 21(a)."

II.

TYPES OF LIEN CREDITORS.

The types of lien creditors whose priority will be established in this proceeding are broken down as follows:

(1) Court costs.
(2) West Virginia real estate taxes.
(3) Lien of H. B. Agsten & Sons, Inc., the prime contractor.
(4) Liens of subcontractors.
(5) Deed of trust, Huntington Trust and Savings Bank.
(6) Deed of trust, Small Business Administration.
(7) Federal tax liens.
(8) Subsequent mechanic's liens.
(9) Judgment liens and Federal tax liens.
(10) Wage earner's liens.
(11) Common creditors.

III.

PRIORITIES.

It is the opinion of the special master that the priorities of the liens of the respective claims filed in this proceeding are as hereinafter enumerated.

(1)

Court costs.

It is elementary that court costs, including the costs of this proceeding have first priority.

(2)

West Virginia real estate taxes.

Real estate taxes due to the Sheriff of Mason County, West Virginia, now due and payable for the year of 1965 in the amount of $580.15, plus interest to the date of payment are next in priority.

The 1966 taxes are a lien but are not due and payable until August, 1966, and if this matter is not disposed of prior to the time they are payable, they will attain the same status as the 1965 taxes. The Supreme Court of West Virginia in the case of Ernest, et al. v. West Virginia Smokeless Fuel & Power Company, et al., 113 W. Va. 282, decided that "* * * the lien for taxes is superior to all other liens whatsoever, except judicial costs." It is further to be noted that the real estate taxes are specifically superior to the lien of the S.B.A. deed of trust by statute. Title 15, Section 646, U.S.C. provides:

> "Any interest held by the Administration in property, as security for a loan, shall be subordi-

nate to any lien on such property for taxes due on the property to a State, or political subdivision thereof, in any case where such lien would, under applicable State law, be superior to such interest if such interest were held by any party other than the United States."

(3)

Lien of H. B. Agsten & Sons, Inc., the prime contractor.

The construction of the premises for the Defendant by H. B. Agsten & Sons, Inc., to be referred to herein as the Contractor, was commenced on May 29, 1964. The mechanic's lien filed by the Contractor was timely. The work was commenced prior to the recordation of the deed of trust lien of the Huntington Trust and Savings Bank of Huntington, West Virginia, and the deed of trust lien of the S.B.A. Under West Virginia law the Contractor has priority over both the Bank and S.B.A. under the "first in time is first in right" principle. However, due to the testimony and evidence presented in this hearing and the finding by the special master that the Defendant is insolvent, the West Virginia law is, in fact, superseded by the insolvency statute of the Federal Government quoted below (Title 31 U.S.C. 191), and the debt due the United States by reason of the deed of trust in favor of the S.B.A. has a priority status.

The Federal statute (Title 31 U.S.C. 191) which establishes priorities in the cases of insolvency, provides:

"Whenever any person indebted to the United States is insolvent,* * * the debts due to the United

> States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, * * * as to cases in which an act of bankruptcy is committed."

The priority of a S.B.A. deed of trust under Title 31 U.S.C. 191 was discussed in the case of Jones, et al. v. Foodco Realty, Inc., et al., 318 Fed. 2d 881, wherein the court held:

> "Under the Federal insolvency statute the United States is accorded absolute priority over claims of general lien holders * * *."

The court further held that

> "The Small Business Administration is an agency of the United States within the debts due to the United States clause of the Federal Insolvency Act and is not a separate legal entity."

In discussing the filing of a mechanic's lien in the above cited case, the court went on to say

> "* * * filing and recording of a mechanic's lien without obtaining final judgment enforcing the lien against the property does not render such lien specific and choate even though the lien has been filed in the manner prescribed by state law and foreclosure proceeding is in progress at the time the Government first asserts its priority."

Therefore, it suffices to say that the S.B.A. deed of

trust under the Federal Insolvency statute above quoted is superior to the lien of the Contractor.

In consequence whereof, the liens of the general contractor and of his subcontractors are ahead of the deed of trust to the Bank and are not valid against the deed of trust to the S.B.A.

It is the opinion of the special master that the amount of the claim of the Contractor should be approved. The S.B.A. filed a counter affidavit to the Contractor's claim and introduced testimony and evidence to the effect that much work and labor remained to be done on the Deefndant's project in an attempt to reduce the amount of the Contractor's claim. The Defendant itself neither appeared nor contested any of the claims filed in this proceeding.

The S.B.A. introduced as their witness Mr. Lewis S. Dozier, a civil engineer with the S.B.A. Mr. Dozier testified (Record, pp. 83-99, 131) that at the request of the S.B.A. he went on the premises (Record, p. 86) on March 31, 1966, and spent the next four or five days examining the Defendant's facilities. The witness testified (Record, pp. 96, 97) that if the S.B.A. liquidation people had to complete the unfinished work and latent defects in the construction of the Defendant's facilities, the cost would be on an entirely different basis than that testified to by the Contractor. He testified that if the Government had to take over and complete the work he termed necessary, he estimated it would cost $76,100.00. Under repeated questioning the witness was unable to testify as to the manner in which he arrived at his figure of $76,100.00 and, therefore, little credence can be afforded his testimony.

On the other hand, John S. Agsten, testifying on behalf of the Contractor (Record, p. 191), said that he had taken statements from all subcontractors necessary to complete the job and that they were willing and able to complete whatever was necessary for the sum of $1,035.23 for unfinished work and $5,831.04 for the repair of latent defects. The special master feels that the testimony of Mr. Dozier is not sufficient to justify the reduction of the claim of the Contractor. The record shows that the plaintiff substantially performed his contract, which is sufficient to preserve his lien.

Therefore, the special master finds the amount of the Contractor-Plaintiff's lien, H. B. Agsten & Sons, Inc., P. O. Box 2707, Charleston, West Virginia, to be in the amount of $217,098.33, with interest in the amount of $8,445.17 calculated to March 10, 1966, plus interest on the principal amount of $35.687 per day until satisfied, the payment of the Contractor's lien to be paid as set out and discussed in Item (5) below; provided, however, the Contractor shall complete the incomplete portion of its work, along with the repair of latent defects as testified to in the hearing which are guaranteed under his contract.

(4)

Liens of subcontractors.

The claim of William H. Meiners, d.b.a. General Floor Company, 715 Oakes Avenue, South Charleston, West Virginia, in the amount of $1,680.00 has been properly proven as a subcontractor's claim against the defendant corporation. This claim represents the claim of a subcontractor under the plaintiff, H. B. Agsten & Sons, Inc. and since it is in proper form shall have

first priority out of sums paid to the plaintiff. Mr. John S. Agsten in his testimony acknowledged the existence of this claim and that it would be paid out of any sums recovered by his corporation.

The claim of the Carolina Lumber and Supply Company, Point Pleasant, West Virginia, in the amount of $569.01 is not in proper form as a subcontractor's claim under the West Virginia statutes and, therefore, the priority cannot be ascertained. However, Mr. John S. Agsten, President of the plaintiff corporation, in his testimony acknowledged that this claim would be paid out of any sums recovered by the plaintiff corporation.

(5)

Deed of Trust,
Huntington Trust and Savings Bank.

The deed of trust of the Huntington Trust and Savings Bank of Huntington, West Virginia, was recorded in the Mason County Clerk's office aforesaid on September 22, 1964, in Trust Deed Book 138 at page 234. This deed of trust is prior in time and first in right to the deed of trust of the S.B.A. dated October 29, 1964, of record in the aforesaid clerk's office in Trust Deed Book 138 at page 465. The Bank's lien is prior to all liens except the court costs, real estate taxes, and the lien of the Plaintiff-Contractor. The Bank is ahead of the S.B.A. by virtue of the actual terms of the S.B.A. deed of trust, which specifically states that its lien is inferior to that of a prior deed of trust executed by the defendant to secure a loan in the amount of $400,000.00. The deed of trust does not recite specifically to whom the lien of $400,00.00 is payable, but the memorandum presented by the S.B.A. to the court acknowledges that the $400,000.00 lien is payable to the Bank.

For the purpose of discussion it might be well to state further that the S.B.A. attains no priority over the Bank by virture of the Federal Insolvency statute heretofore discussed. In the case of U. S. v. Atlantic Municipal Corporation, 212 Fed. (2) 709, 711, which case is cited in 246 Fed. (2) 141, the court stated:

> "This statute applies only as against unsecured debts, that is, debts not secured by a specific and perfected lien. It has never been * * * to accord payment to a debt due the United States in preference to a claim secured by a lien which is prior in time and superior in law to the lien of the United States securing the debt for which preferential payment is sought."

In the case of Exchange Bank & Trust Company, et al. v. Tubbs Manufacturing Company, et al., 246 Fed. (2) 141, there was an insolvent debtor corporation and the United States was attempting to have its debt for taxes first satisfied ahead of the municipal taxes and a prior mortgage lien. The court in this instance held that the United States was not entitled to have its debt for taxes first satisfied ahead of a mortgage lien claim even though the Federal lien had priority over the municipal lien, which had priority over the mortgage lien. The court held that the mortgagee was entitled to payment, subject to first payment there out of the City's tax claims, then the remainder, if any, to the United States.

It is the opinion of the special master that the claim of the Huntington Trust and Savings Bank of Huntington, West Virginia, in the amount of $412,607.00 with interest in the amount of $8,114.62 calculated to

March 28, 1966, with additional interest in the amount of $68.78 per day until satisfied, shall be next after the payment of court costs and real estate taxes. However, out of this sum due the Bank shall be paid the amount due the Contractor, H. B. Agsten & Sons, Inc., P. O. Box 2707, Charleston, West Virginia, in the amount of $217,098.33, with interest in the amount of $8,445.17 calculated to March 10, 1966, plus interest on the principal in the amount of $35.687 per day until satisfied.

(6)

Deed of Trust,
Small Business Administration.

Next in priority after the deed of trust payable to the Bank is the deed of trust executed by the Defendant to the S.B.A. dated October 29, 1964, of record in the aforesaid clerk's office in Trust Deed Book 138 at page 465, the unpaid balance at the time of this hearing being in the amount of $987,500.00, plus interest at 4% until satisfied.

In the claim filed by the S.B.A. before the special master there was an item inserted asking for attorney fees. It is the opinion of the master that attorney fees are not allowable under the law of West Virginia and even if such fee were allowable, no testimony was introduced in support of the same.

(7)

Federal tax liens.

The Internal Revenue Service filed claims on behalf of the United States for withholding taxes, FUTA taxes, and excise taxes, the liens for which arose at

different times. The Federal statutes applicable to these liens are briefly summarized as follows:

(a) Title 26 U.S.C. 6321 creates a lien in favor of the Internal Revenue Service for unpaid taxes, which upon assessment attaches to all property of the debtor and is prior in right to all liens which are not choate and perfected as of that date.

(b) The Federal Insolvency statute discussed at length hereinabove (Title 31 U.S.C. 191) likewise applies to the claim of the Internal Revenue Service.

(c) Title 26 U.S.C. 6323 provides that the tax lien imposed by Section 6321 above cited shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice has been recorded in the county clerk's office in the county where the debtor's property is located.

The liens of the Internal Revenue Service cannot rise higher than the perfected liens of the deeds of trust of the Bank and the S.B.A., nor above the liens for real estate taxes, court costs, and judgment creditors of record prior to the filing of the I.R.S. notice of its tax lien.

Therefore, the special master is faced with the same circuity of claims as described with relation to the claims of the S.B.A., the Bank, and the Contractor. The mechanic's liens listed under Item (8) hereafter are behind the priority of the I.R.S. liens by virtue of the Federal Insolvency statute cited under Item (3) but ahead of the judgment lienors in Item (9) under the first in time first in right principle. Therefore, the mechanic's liens in Item (8) would be payable from the proceeds of judgment creditors, which are prior to the

I.R.S. liens in the manner discussed under Item (5) in the case of Exchange Bank & Trust Company, et al. v. Tubbs Manufacturing Company, et al., 246 Fed. (2) 141.

From the total of the liens set out in Items (1) to (6) amounting to over $1,400,000.00, not including sale costs, court costs, and additional interest, it seems apparent to the special master that any sale of the real estate of the Defendant to satisfy these claims would not bring sufficient proceeds to satisfy liens discussed in Items (7) to (10). Therefore, the priority of the liens in Items (7), (8), and (9) are not set out as precisely as in the previous items. It suffices to say that the same statutes and the same court decisions apply to these subsequent liens and the payment thereof as to those already discussed.

The I.R.S. liens will be set out in their proper order as between judgment liens under Item (9) and not enumerated at this point.

(8)

Subsequent mechanic's liens.

The Contractor-Plaintiff's mechanic's lien was the result of a direct contract with the Defendant. The mechanic's liens hereinafter set out were created by virtue of individual contracts with the Defendant and were not a part of the Contractor's original contract. The liens were all created in the year 1965 on the dates indicated and after the creation of the Contractor's lien and the trust deed liens of the Bank and the S.B.A.

West Virginia Code 38-2-17 provides:

"All of the liens authorized and created by this article shall, except as provided in Section 3752 of

this article, have priority over any and all other liens created by trust deed or otherwise * * * subsequently to the time such labor shall have begun to be performed, or such material or machinery or other necessary equipment shall have begun to be furnished."

West Virginia Code 38-2-18 provides as to priority

"* * * But all of such perfected liens of such laborers and workmen and of such materialmen and furnishers of machinery and of such contractors and subcontractors, respectively; shall be of equal dignity without priority among themselves * * *".

It is the opinion of the special master that the two statutes above quoted do not raise the priority of the hereinafter mechanic's lien holders to that of the priority of the Contractor. The testimony and the proofs of claim filed indicate that these mechanic's lien holders dealt directly with the Defendant and were not a part of the original contract of the Contractor. The statute is clear that the mechanic's lien cannot be superior to prior liens created by trust deed or otherwise. If these liens were part of the original contract with the Contractor and not subsequent contracts with the Defendant, their priority would be ahead of the Bank.

This is not the case and, therefore, their priority follows that of the I.R.S. and under the provisions of West Virginia Code 38-2-18 above cited, they are of equal dignity without priority among themselves.

The Contractor filed a counter affidavit in opposition to the proof of the mechanic's lien of B & L

Furniture Company, a hearing on which was held on April 19, 1966, resulting in a reduction in the amount of the Furniture Company's lien to $48,195.45.

The contention of the Contractor was to the effect that after reduction of the amount of the lien as hereinabove stated, the balance of the lien of the Furniture Company was represented by carpeting which was not proper subject matter for a mechanic's lien.

This problem is new to this jurisdiction and normally carpeting is not considered part of the realty as such. However, testimony and evidence was produced to the effect that the carpeting was specially loomed, cut, and affixed to unfinished rough concrete floors and not readily re-saleable. Under these circumstances, it is the opinion of the special master that the carpeting is a fixture and the proper subject matter of a mechanic's lien.

The mechanic's liens of equal priority are as follows:

4/ 7/65	Andersons'-Black Rock, Inc. P. O. Box 1388 Charleston, West Virginia	$ 3,690.00
4/15/65	B & L Furniture Company, Inc. Williamson, West Virginia (This claim was reduced as a result of a hearing on April 19, 1966, from the original amount of $59,143.79. The balance of $10,948.34 is shown under Item (9) as a judgment lien)	48,195.45

5/10/65	Minter Homes Corporation Huntington, West Virginia	3,045.31
5/11/65	Mechanical Contractors, Inc. P. O. Box 1602 Charleston, West Virginia	15,063.32
5/28/65	Harris Brothers Roofing Company 1518 Hansford Street Charleston, West Virginia 25311	436.52
7/31/65	Bayliss & Ramey, Inc. 5330 MacCorkle Avenue, S. W. South Charleston, West Virginia	9,287.88

It may be well to note that the S.B.A. filed counter affidavits to each and every mechanic's lien proof of claim filed in this proceeding, except the mechanic's lien filed by Andersons'-Black Rock, Inc. At the hearing held on April 1, 1966, the S. B. A. withdrew all of their counter affidavits, except the one filed against the Contractor, on which a hearing was held on that date, the results of which have been enumerated above.

(9)

Judgment liens and Federal tax liens.

The special master finds the following priorities as between the various Federal tax liens and judgment lienors, together with the dates and amounts. As discussed under Item (7) the judgment liens hereinbelow set out are not prior to the mechanic's liens under Item (8) but the I.R.S. liens are prior to the mechanic's liens under Item (8) by reason of the Federal Insolvency statute and must be dealt with in the event funds are sufficient to pay all lien creditors in the manner set out under Item (7).

10/28/65	Judgment (Civil Action 1386) Standard Food Service, Inc. c/o R. G. Musgrave, Attorney at Law, Point Pleasant, West Virginia	$ 2,178.32	
	Costs	20.00	$ 2,198.32
	Interest from 10/28/65		?
11/ 4/65	Internal Revenue Service Withholding taxes		3,231.35
	Interest from 3/18/66		?
12/ 7/65	Internal Revenue Service Withholding taxes		8,935.29
	Interest from 3/18/66		?
12/31/65	Judgment (Civil Action 1428) Lonnie Stafford, d.b.a. Stafford's Professional Photography, c/o R. G. Musgrave, Attorney	680.80	
	Costs	20.00	700.80
	Interest from 12/31/65		?
12/31/65	Judgment (Civil Action 1427) The Hamilton Provision Company, c/o R. G. Musgrave, Attorney	5,580.37	

	Costs	20.00	5,600.37
	Interest from 12/31/65		?
1/ 3/66	Judgment (Civil Action 1420) William Iselin and Company, Inc., assignee of Turner Manufacturing Company, c/o William H. Rardin, Attorney at Law, Pt. Pleasant, West Virginia	3,860.55	
	Costs	20.75	3,881.30
	Interest from 1/3/66		?
1/ 7/66	Judgment (Civil Action 1403) Carolina Lumber Company, Point Pleasant, West Virginia		1,068.86
2/ 3/66	Internal Revenue Service Excise taxes		89.44
	Interest from 3/18/66		?
2/18/66	Internal Revenue Service Withholding taxes		5,618.49
	Interest from 3/18/66		?
2/18/66	Internal Revenue Service, F.U.T.A. taxes		2,965.30
	Interest from 3/18/66		?

2/18/66	B & L Furniture Company, Inc., Williamson, West Virginia, Balance on judgment		10,948.34
2/25/66	Judgment (Civil Action 1460) Kroehler Manufacturing Co., c/o Ernest H. Gilbert, Attorney, P. O. Box 1513, Charleston, West Virginia	$45,332.43	
	Costs	20.00	$45,352.43
	Interest from 2/25/66		?
3/11/66	Internal Revenue Service Excise taxes		70.89
	Interest from 3/18/66		?
3/11/66	Internal Revenue Service Excise taxes		16.74
	Interest from 3/18/66		?

(10)

Wage earner's liens.

Under the provisions of West Virginia Code 38-2-31 and 32, there is provision for a laborer's or wage earner's lien against a corporation. If properly perfected, the laborer or wage earner shall have a lien for the value of such work or labor upon all real estate and personal property of such company to the extent and value of one month's work or labor, which shall

have priority over any lien created by deed or otherwise, subsequent to the time when such work and labor was performed.

Under the provisions of these sections of the West Virginia Code seven wage earners perfected their liens for one month's wages, which liens were all created in February, 1966, and are next in priority. They are as follows:

Helen D. Holcombe Box 5107, Capitol Station, Charleston, West Virginia	$ 82.00
Luther D. Miller	624.00
Mabel Carver	180.00
Irene Wise	50.47
Josephine Fox 2607 Garfield Avenue, Point Pleasant, West Virginia	200.00
Hazel Ewing 1307 Viand Street, Point Pleasant, West Virginia	200.00
Jessie Lee Madison	533.47

Michael E. Whalen perfected his lien as assistant reservation clerk for the defendant corporation from December 31, 1964, to February 7, 1965, in the amount of $241.50. The claim filed does not set out the amount per month and, therefore, the amount of his priority for one month's wages cannot be ascertained from the amount in his proof of claim.

Helen D. Holcombe, in addition to her preferred claim of $82.00, has an amount of $232.00, which should be payable before any common creditors.

(11)

Common creditors.

This is a suit originally started by the plaintiff to enforce its mechanic's lien and, consequently, the order of reference to the undersigned special master required, among other things, the ascertainment of liens against the real estate involved in the proceeding and their priorities. However, many common creditors filed claims, some in proper form and some not. Although they have no place in this proceeding, the claims of the common creditors filed are listed as follows:

Reeves Broadcasting & Development Corporation 625 Fourth Avenue, Huntington, West Virginia	$ 525.00
O-Kan Dairy Corporation 312 Sixth Street, Point Pleasant, West Virginia	1,461.69
John J. McCormack Advertising, Inc. Huntington, West Virginia	10,408.72
Cecil B. Dean, Attorney at Law 215 Sixth Street, Point Pleasant, West Virginia	3,890.00
Ralph L. Shannon, securing finances Huntington, West Virginia	4,000.00
John H. Collins, and others, for rent on lease of adjoining land c/o William H. Rardin, Attorney, Point Pleasant, West Virginia	2,450.00
Duke Cleaners, uniform rental	11,220.00
Humphrey's, sheet metal work Box 105, Point Pleasant, W. Va.	42.00

Green's Country Ham House, hams Milton, West Virginia	63.75
Fred Green, eggs for July, August, and September Fraziers Bottom, West Virginia	180.00
Bar-Master Sales and Service 212 Ninth Avenue, Huntington, West Virginia	2,867.76
Rolfe Lee, loans and advancements Gallipolis Ferry, West Virginia	143,169.77
L. A. Wright and Isabelle Wright, for four unsecured notes totaling Henderson, West Virginia	28,710.00
Camp Conley Public Service District, water and sewer Point Pleasant, West Virginia	1,375.50
Holswade Office Suppliers, Inc. office equipment 742 Fourth Avenue, Huntington, West Virginia	265.86
J. M. H. Bayliss, for note dated May 26, 1965 (original amount $13,000.00)	12,612.50
State Electric Supply Company 1921 Third Avenue, Huntington, West Virginia	209.54
Seven-Up Bottling Company, open account 114-16 Eighth Avenue, Huntington, West Virginia	109.70
Wagoner Construction Company, Inc. balance on account P. O. Box 1127, Salisbury, North Carolina.	2,000.00

An affidavit was filed before the special master by W. E. Mohler, 971 Ridgemont Road, Charleston, West Virginia, made on behalf of R. L. Boyer, formerly doing business as R. L. Boyer Company, which stated that the defendant corporation as of March 16, 1965, was indebted to the claimant in the amount of $4,561.20, with interest until paid, for the furnishing of materials and doing the work and labor necessary for completion of the painting on the Defendant's building, which is the subject matter of this litigation. Nothing further was proved before the special master and there is no proof that the claimant ever perfected any mechanic's lien. Therefore, unless something further is presented to the court in this regard, this claim will have to be treated as the claim of a common creditor.

The following employees made claim for wages due, but no proof was furnished the special master that their liens were perfected in accordance with West Virginia Code 38-2-31 and 32.

The special master, by letter to each of the claimants, advised them that their claims were in improper form and unascertainable as to priority, but the claimants did not choose to correct their proofs of claim. Therefore, the special master has no alternative but to list the following as common creditors and not lien creditors in this proceeding.

L. A. Wright,
Henderson, West Virginia,
Salary, October, 1961, to March 1, 1966 $23,400.00

Rolfe Lee,
Gallipolis Ferry, West Virginia,
Salary, October, 1961, to March 1, 1966 26,000.00

Lonnie Spurlock, 204 N. Park Drive, Point Pleasant, West Virginia, 7 weeks' wages	525.00
Virginia Roush, Hartford, West Virginia	159.50
Linda Roach, 2203 Jefferson Avenue, Point Pleasant, West Virginia, Wages, January 1, 1966, until closed	136.90
Timothy O. Litchfield, Route 1, Box 121, Point Pleasant, West Virginia, 3 weeks, 2 days, wages	80.70
John Clendenen, 132 S. Park Drive, Point Pleasant, West Virginia, 7 weeks' wages	525.00
Guy Bush, Hogsett, West Virginia, 7 weeks' wages	402.50
Delores Bumgarner, New Haven, West Virginia, Wages as waitress	175.00
Alma Zimmerman, Box 133, Clifton, West Virginia, 7 weeks' wages as cook and maid	361.60
Daisy L. Brown, 2326 Lincoln Avenue, Point Pleasant, West Virginia, Wages as maid	390.61

(C)

FOURTH REQUIREMENT.

ALL OTHER MATTERS PERTINENT TO THIS CAUSE WHICH THE SPECIAL MASTER MAY BE REQUESTED IN WRITING BY ANY PARTY TO THIS ACTION TO ASCERTAIN OR WHICH THE SPECIAL MASTER MAY DEEM PERTINENT.

No party to this action requested a finding on any other matter, but the special master deems the following to be pertinent.

Pursuant to West Virginia Code 38-2-25 it is necessary to determine when a perfected lien is sought to be enforced against property outside of any city, town, or village, how much of such land surrounding any such building shall be subject to such perfected lien or liens.

The special master finds that the entire thirty-one acres of land described in detail under the First Requirement above shall be subject to the liens hereinabove ascertained for the reasonably necessary full enjoyment of such building and other improvements.

Respectfully submitted this 6th day of May 1966.

(s) George S. Wallace, Jr.,
Special Master.

Opinion of the United States Court of Appeals for the Fourth Circuit

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United States Court of Appeals
FOR THE FOURTH CIRCUIT

No. 11,028.

H. B. Agsten & Sons, Inc., a corporation,
Appellee,

versus

Huntington Trust & Savings Bank, a corporation,
Appellant.
and
Bernard L. Boutin, Administrator, Small Business Administration, and Odus R. Kincaid and Delbert E. Williams,
Trustees,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA, AT HUNTINGTON. SIDNEY L. CHRISTIE, DISTRICT JUDGE.

(Argued April 6, 1967. Decided December 4, 1967.)

Before HAYNSWORTH, Chief Judge, and SOBELOFF and BRYAN, Circuit Judges, and with the consent of the parties submitted to the Court en banc.

Selden S. McNeer, Jr., (Campbell, McNeer, Woods, Bagley & Emerson on brief) for Appellant; Howard R. Klostermeyer (William B. Maxwell, III, and Spilman, Thomas, Battle & Klostermeyer on brief) for Appellee H. B. Agsten & Sons, Inc., and John C. Eldridge, Attorney, Department of Justice, (Barefoot Sanders, Assistant Attorney General, Morton Hollander and Robert C. McDearmid, Attorneys, Department of Justice, and Milton J. Ferguson, United States Attorney, on brief) for Administrator and Trustees of Small Business Administration.

SOBELOFF, Circuit Judge:

With the facts undisputed, the only issue for our determination in this circuity of lien priorities case is the proper distribution of the proceeds from a judicial sale of property.[1] We think that the District Court's disposition satisfactorily accommodates the competing interests of state and federal law and the opposing claims of the three litigants—a mechanic's lienor, a mortgagee bank and the Small Business Administration. Accordingly, we affirm the court's decision to give priority to the bank and the remainder to the SBA, while requiring the bank to satisfy the mechanic's lien in full from its recovery.

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[1] The property was sold prior to the hearing of this appeal for $700,000. The aggregate amount due the three principal lienors is approximately $1,600,000 as follows: The Small Business Administration $1,042,500.00, Huntington Trust & Savings Bank $400,000.00 and H. B. Agsten & Son, Inc. $217,098.33. Therefore, we ignore in this opinion a myriad of inferior liens also outstanding against the insolvent debtor.

On June 1, 1964, plaintiff H. B. Agsten & Son, Inc. began construction of a motel for the West Virginia Industries Development Corporation on a 31-acre tract of land owned by the developer in Mason County, West Virginia. Almost four months thereafter, on September 22, 1964, to help finance the venture, West Virginia Industries borrowed from the Huntington Trust & Savings Bank $400,000.00, secured by a recorded deed of trust conveying the tract to the Bank's trustees. Finding itself in need of more capital one month later, West Virginia Industries executed and on October 30, 1964, recorded a second deed of trust conveying the same property to secure a loan of $1,042,500.00 from the Small Business Administration. This agreement provided:

> "This Deed of Trust and warranty of title herein are made subject to and subordinate to a prior deed of trust executed by the grantor herein to secure a loan in the amount of $400,000.00 over the premises herein conveyed, and now of record in the office of the Clerk of the County Court of Mason County, West Virginia."

There can be no doubt, as the Special Master to whom the District Court referred this case found, that this language alluded to the Bank's earlier loan to West Virginia Industries.

After substantially completing the motel in June, 1965, Agsten timely recorded a notice of mechanic's lien in the county clerk's office for $217,098.33, the balance admittedly due the contractor. With its debtor insolvent, Agsten instituted this action in a state court of West Virginia, seeking a determination of the valid-

ity and priority of outstanding liens against the property of West Virginia Industries, and requesting a sale to satisfy these liens. SBA, a named defendant, had the case removed to the Federal District Court.

The circuity of lien priorities arises because of an apparent conflict between certain federal and state statutes, whose applicability in this case is undisputed. The Federal Insolvency Statute, 31 U.S.C. 191, provides:

> "Whenever any person indebted to the United States is insolvent * * *, the debts due to the United States shall be first satisfied; and the priority established shall extend * * * to cases in which an act of bankruptcy is committed."

Since the parties do not contest the Special Master's finding that West Virginia Industries was insolvent and had committed the requisite act of bankruptcy, it is clear that the claim of the SBA, a federal agency, is entitled to preference over Agsten's mechanic's lien, which was inchoate when the SBA loan was made. See *Small Business Administration* v. *McClellan,* 364 U.S. 446 (1960); *W. T. Jones & Co.* v. *Foodco Realty, Inc.,* 318 F.2d 881 (4th Cir. 1963). The Bank, however, enjoys a priority over SBA both because of the explicit language in SBA's deed of trust and because of a judicially-created exception to the insolvency statute in favor of previously executed mortgages. See *United States* v. *Texas,* 314 U.S. 480, 484 (1941). To complete the circle, Agsten has a claim superior to the Bank's by

virtue of the laws of West Virginia.[2]. The resulting paradox is that the Bank is behind the contractor and ahead of the SBA, which is in turn ahead of the contractor.

In resolving this problem, we follow what has been correctly termed the "federal policy"[3] in this area. We start with the basic proposition that federal law determines the relative priority of conflicting claims where a federal agency is involved. *United States* v. *Clover Spinning Mills Co.*, 373 F.2d 274, 276 (4th Cir. 1966). It is by applying federal law that we have determed that SBA's claim is superior to Agsten's but

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[2] West Virginia Code (Michie ed. 1966) § 38-2-1. Lien of Contractor.

"Every person, firm or corporation, which shall erect, build, construct, alter, remove or repair any building or other structure, or other improvement appurtenant to any such building or other structure, under and by virtue of a contract with the owner for such erection, building, construction, alteration, removal or repair, either for an agreed lump sum or upon any other basis of settlement and payment, shall have a lien upon such building or other structure or improvement appurtenant thereto, and upon the interest of the owner thereof in the lot of land whereon the same stands, or to which it may have been removed, to secure the payment of such contract price or other compensation therefor."

§ 38-2-17. Priority of Mechanics' Liens Over Other Liens.

"All of the liens authorized and created by this article shall * * * have priority over any and all liens created by trust deed or otherwise, on such building or other structure and improvements appurtenant thereto and on the owner in the lot of ground whereon the same stands or to which the same may have been removed, subsequently to the time when such labor shall have begun to be performed, or such material or machinery or other necessary equipment shall have begun to be furnished."

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[3] Kennedy, The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien, 63 Yale L.J. 905, 927 n. 128 (1954).

inferior to the Bank's. Federal law demands only that after the payment of the $400,000.00 to which the SBA is subordinated, this federal agency should be recompensed for its loan to the extent possible. At this point, the interest of the federal government terminates, and the ultimate disposition of the $400,000.00 is purely a matter of state concern. *United States* v. *New Britain,* 347 U.S. 81, 88. (1954). In our case, the State of West Virginia has determined by its statutes that the contractor is to be paid in full before the mortgagee's claim is satisfied.

New Britain is precisely in point here. Applying federal law, the Supreme Court found that certain liens of the United States were superior to a number of municipal liens but inferior to outstanding mortgage and judgment liens. However, under the relevant state law, the mortgage and judgment liens were inferior to the municipal liens. In reversing a disposition similar to one of those contended for by the appellant here, the Court declared:

> "The United States is not interested in whether the State receives its taxes and water rents prior to mortgages and judgment creditors. *That is a matter of state law.* But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. (Emphasis added.)

On remand, the state court set aside the amount of the mortgage and judgment liens, ordered the remainder paid to the federal government, and directed payment of the municipal liens from the funds appropriated to the mortgage and judgment liens. *Brown* v. *General Laundry Service,* 19 Conn. Supp. 335, 111 A.2d 601

(1955). This is the very method employed by the District Court in the instant case and by a consistent line of federal authorities. *See, e.g., In Re Lieb Bros., Inc.*, 251 F.2d 305 (3rd Cir. 1957); *Exchange Bank & Trust Co.* v. *Tubbs Manufacturing Co.*, 246 F.2d 141 (5th Cir. 1957); *United States* v. *Lord*, 155 F. Supp. 105 (D.N.H. 1957). *See also Samms* v. *Chicago Title & Trust Co.*, 349 Ill. App. 413, 111 N.E. 2d 176 (1953). The fact that the lien in *New Britain* arose under the federal tax laws while in this case the priority emanates from a contractual obligation, is not a legally significant distinction in resolving the issue before us. Although, as we shall show, the substantive scope of the Federal tax laws differs from that of the Federal Insolvency Statute, the technique to be utilized in reconciling the divergent interests, once they have been determined, should be the same.

The result we reach here is justified not only by precedent but also by sound policy considerations. Agsten began improving the land in June, 1964, secure in the knowledge that state law accorded it a priority over any subsequent local mortgage. When the bank advanced money to West Virginia Industries nearly four months later, it must be presumed to have been well aware that its repayment would be subordinated to the prior mechanic's lien. The fortuitous appearance of a federal agency one month later should not inure to the Bank's benefit by depriving the contractor of its $217,000. Similarly, it is proper that SBA be paid all of the excess over $400,000, the specific amount by which the law and its agreement purported to subordinate its claim. If the SBA were subordinated not only to previously executed mortgages but also to inchoate mechanic's liens, there is a possibility it would refuse to make such loans, thereby diminishing the effective-

ness of the Small Business Act, 15 U.S.C. §§ 631-51. And had the SBA declined to make its million dollar loan, the Bank might on insolvency of the landowner recover less because, as no federal law would be involved, Agsten would come ahead of the Bank in the distribution of a fund not enhanced by the massive federal investment.

Neither of the Bank's suggested alternative solutions achieves a similarly desirable reconciliation of the respective interests. The Bank first posits a theory whereby $217,000 is awarded to Agsten, then the Bank is paid in full, and finally SBA is decreed the remainder. This alternative, which would emasculate the Federal Insolvency Statute, was specifically rejected by the Supreme Court in the *New Britain* case, *supra*.

The second approach, which the Bank urges more strenuously, would first set aside the $217,000 owed to Agsten, but pay it to the SBA instead of Agsten, for SBA is superior to the building contractor under the federal statute. The Bank would then be repaid in full, with the remainder going to SBA. The net result would be that the Bank would enjoy full recovery, the SBA would recoup more than half of its outlay and Agsten would be cut out completely. This solution offends the West Virginia lien statutes, which unequivocally afford a preference to mechanic's liens; the Federal Insolvency Statute, which is not meant to inure to the benefit of private creditors vis-a-vis other private creditors; and our sense of equity, which demands that this contractor who improved the land should not go uncompensated.

In short, while the Bank complains that it is the only party which suffers from the District Court's disposition, the fact is that it "suffers" only in the

sense that by the operation of the West Virginia law and not by reason of the Federal Insolvency Statute, it will regain only about half of its loan. It should also be noted that the Bank is the one party involved which could have protected itself. It could have safeguarded its interest by obtaining a waiver of earlier mechanics' liens before making the loan. By contrast, SBA had no reason to guard against a mechanic's lien, from which it is protected by federal law. Similarly, Agsten had no need to seek protection against the Bank's future mortgage, for the West Virginia statute explicitly afforded it this security.

It has been suggested that the Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125, amending 26 U.S.C. § 6323, impliedly calls for a different result in this case. The thesis is that since the recent legislation subordinates unrecorded federal tax liens to mechanics' liens, federal contractual claims should be similarly affected. If accepted, this theory would result in paying both the contractor and the Bank in full before applying any of the proceeds to SBA's claim. The language and legislative history of the statute, however, convince us that Congress did not purpose to elevate inchoate mechanics' liens over federal contractual claims. The terms of the statute and the detailed Committee reports of both houses of Congress[4] speak repeatedly of subordinating federal unrecorded *tax* liens to mechanics' liens, never intimating a design to broaden the subordination to include other federal claims.

The 1966 amendment, insofar as it pertains to our present inquiry, is simply the latest in a series designed

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[4] S. Rep. No. 1708, 89th Cong. 2d Sess. (1966); H. Rep. No. 1884, 89th Cong. 2nd Sess. (1966).

to effect precisely limited expansions of the category of secured creditors protected from secret federal tax liens.[5] The insolvency statute at issue here, and the tax lien law are entirely separate entities, no matter how related they may become upon occasion. Covering all debts owing the federal government by an insolvent debtor, the insolvency statute, as has long been established, does not create a lien but simply establishes a priority. *Beaston* v. *Farmer's Bank of Delaware,* 12 Peters 102, 134 (U.S. 1838); *United States* v. *Fischer,* 2 Cranch 358, 390 (U.S. 1805). On the other hand, the revenue act, by its terms applies only to tax debts, does create a lien and encompasses all taxpayers regardless of their solvency. In the most scholarly and comprehensive article yet written about the new tax law, Professor Young of Columbia Law School observes that the Federal Insolvency Statute and the 1966 Federal Tax Lien Act raise an "entirely different set of issues." Young, *Priority of the Federal Tax Lien,* 34 U. Chi. L. Rev. 723, 725 (1967).

The inapplicability of the tax law is underscored by a recent Supreme Court decision, which ruled that the tests for determining the choateness of an earlier lien differ depending upon whether the insolvency statute or the tax lien law is involved. *United States* v. *Vermont,* 377 U.S. 351, 357-8 (1964). Interestingly, the Court's approach is consistent with the 1966 amendment insofar as the decision gives a prior lien a better chance against a federal tax lien than against an insolvency priority.

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[5] Professor Kennedy chronicles the amendments whereby purchasers, mortgagees and judgments creditors (37 Stat. 1016 [1913]) and pledgees (53 Stat. 882-3 [1939]) were accorded protection from unfiled federal tax liens. Kennedy, op. cit., at 921-2.

We cannot say that it is illogical for Congress to deem it desirable to retain a priority for money it loans, while relinquishing the priority for its tax liens, which represent no financial outlay. Whatever may be the merits of symmetry in these two quite distinct, if cognate, areas the argument seems more properly addressed to Congress than to this Court.

Finally, in brief response to our Brother Bryan we observe, with deference, that his dissent is marked by two basic fallacies. The first is the unsupportable interpretation of the SBA-Landowner contract that the SBA not only subordinated its mortgage to the extent of $400,000, but that it in some unexplained fashion obligated itself to *pay off* the Bank's mortgage in full. Of course no such obligation has been stipulated by the parties or implied by law. The second erroneous assumption is that the priority accorded by federal law to the SBA mortgage over the mechanic's lien must be converted into a priority in favor of the bank over the mechanic's lien. There is no justification for giving the bank a windfall at the expense of the mechanic in disregard of the order of priorities set by state law as between the mechanic and the bank.

The judgment of the District Court is

Affirmed.

HAYNSWORTH, Chief Judge, concurring:

I join the opinion of the Court, because of the relevant decisions of the Supreme Court treating the claims of mechanics lienors as inchoate and subordinate to a variety of secured claims of the United States, though, under state law, the mechanics lien would be entitled to priority. I must confess, however, consider-

able doubt about the legitimate viability of the Insolvency Statute as applied in such recent cases as *Kentucky* v. *United States,* 6 Cir., 383 F.2d 13. Indeed, were it not for the decision of the Supreme Court in *United States* v. *Vermont,* 377 U.S. 351, I should think we would be confronted in this case with a grave question of the survival of the Insolvency Statute after enactment of the Federal Tax Lien Act of 1966.[1]

It is most unfortunate that the Congress, when considering the Federal Tax Lien Act of 1966, did not focus its attention specifically upon the Insolvency Statute. Had it done so, I am confident the Insolvency Statute would have been repealed or substantially amended, for all of the time, attention and effort expended in drafting, considering and passing the Federal Tax Lien Act of 1966 will be fruitless, except in bankruptcy cases, if the Insolvency Statute is applied to preserve the super-priorities which the Federal Tax Lien Act of 1966 undertook to withdraw from tax claims. The question of priorities is wholly or largely academic, unless the debtor is insolvent, and the clearly stated purpose of the Federal Tax Lien Act of 1966 was to regulate the priority of federal tax claims when competing for payment out of the assets of an insolvent taxpayer with secured claims which would enjoy priority under state law.

The failure of Congress to deal specifically with the Insolvency Statute when amending the federal tax lien statute leaves a lurking question arising out of *United States* v. *Vermont, supra,* which suggests a definite independence between the two statutes and differences in their meaning and application. In *Vermont,* the opinion of the Supreme Court states that

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[1] Pub. L. 89-719, 80 Stat. 1125.

the taxpayer was solvent, though from the opinion in the Court of Appeals,[2] it would appear that there was simply an absence of proof of insolvency, such proof being wholly unnecessary under the federal tax lien statute, but its decision suggests that, when the taxpayer is insolvent, the only probable occasion for litigation about the matter, the Insolvency Statute should be applied without regard to the unamended tax lien statute.

The subsequent enactment of the Federal Tax Lien Act of 1966 and its legislative history may lead the Supreme Court to a different conclusion in dealing with federal tax claims when the Government has elected to invoke the Insolvency Statute rather than the Tax Lien Act of 1966, but, in the present circumstances, in light of *Vermont's* rationale, I cannot say that the Federal Tax Lien Act of 1966 by implication repealed the Insolvency Statute entirely so as to be inapplicable to a contractual claim, or so modified it as to accommodate the priorities which would be recognized if the distribution were being effected by a court in bankruptcy.

Without specific congressional consideration of the Insolvency Statute or a fresh reconsideration of it by the Supreme Court, it remains an anachronism under which federal claims are accorded greater priority when the distribution of the assets of an insolvent debtor is being effected under state law than when it is being effected under the Bankruptcy Act, under which federal tax claims may be arguably entitled to priorities which the Federal Tax Lien Act of 1966 would deny them, and under which other government claims, deferred to tax claims in bankruptcy, may be

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[2] 2 Cir., 317 F.2d 446.

entitled to greater priority under a state regulated distribution of the insolvent's assets.

In light of the course of decision in the Supreme Court, I do not think this Court in this case is free to consider a judicial development of rational answers. I mention the problems, for it seems to me that, particularly after enactment of the Federal Tax Lien Act of 1966, there is an urgent need for congressional attention to the Insolvency Statute, so that what, if anything, was intended to be left of it may be made manifest.

ALBERT V. BRYAN, Circuit Judge, dissenting:

In my judgment the proceeds of sale should be distributed in this manner:

First, pay SBA the money owing on its mortgage;

Second, from this money require SBA to reimburse the Bank its loan of $400,000; and

Third, to the mechanic's lien any moneys left after payment of SBA's loan.

The subordination stipulation in the Small Business Administration mortgage wholly distinguishes this case from the Government-priority-lien and the circuity-of-lien decisions on which the majority relies, e.g., United States v. New Britain, 347 US 81 (1954). Although not so couched in terms, actually it is a covenant to pay the Bank's loan from SBA's recovery. The assurance is effectuated through the extension to the Bank of the benefit of SBA's overriding priority.

I. To start with, the majority errs in deciding the Bank's rights on the basis of the State law. The claim of the Bank rests entirely on Federal law. Priority as

between the liens of the Bank and SBA is established solely by Federal criteria. W. T. Jones & Co. v. Foodco Realty, Inc., 318 F2d 881 (4th Cir. 1963). The primacy claimed by the Bank is not founded on State law. It is supported to a point, as will more explicitly appear immediately, by the decision in United States v. Texas, 314 US 480 (1941) but it is only fully established by SBA's mortgage stipulation. There can be no doubt that Federal law governs interpretation of the meaning and force of the stipulation.

II. The presence of the SBA mortgage following the Bank mortgage was not, as the majority would have it, simply a fortuitous circumstance. SBA's mortgage complemented the Bank's. The two loans had a single object, the provision of moneys for a project admittedly within the field of the Small Business Administration.

SBA policy in furnishing aid is to avoid interference with private financing. If it had placed the mortgage without having an understanding with the Bank, it might have pulled down the entire enterprise. This is true because the SBA mortgage might otherwise, as will soon appear, prevail over the Bank mortgage and thus destroy or dangerously impair its security. The Bank was not compelled to suffer a confiscation of this kind through an agreement of the owner and SBA alone. Such an act of the owner would certainly be an abrogation, or default, of an in the inherent condition of the mortgage that the security not be removed. Seemingly it would, also, be a breach of the owner's warranties in the Bank's mortage.[1] The moment the

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[1] The owner's warranties were as follows:

"Grantor covenants that said real estate is free from all liens and incumbrances whatsoever, and that **he will warrant generally said real estate.**" (Accent added)

SBA mortage was recorded, the Bank's security was jeopardized. Thereupon the Bank would have the right to restrain its consummation or to foreclose unless this threat was abated. Obviously, SBA did not intend to bring about a collapse of the whole venture. No private mortgage would be obtainable on SBA-eligible projects if an owner and SBA, without the assent of the private lender, could completely dissolve the latter's security. The stipulation in the SBA mortgage was plainly inserted to bar that possibility.

The statute did not in terms give a private mortgage a place above a subsequent Government mortgage, and the decisional law was by no means clear in so preferring it. The nearest approach was United States v. Texas, supra, 314 US 480 (1941) where the uncertainty appears in the words of the Court, p. 484:

> "Section 3466 [now 31 USC 191] mentions no exceptions to its requirement that 'the debts due to the United States shall be first satisfied.' It is nevertheless true that in several early decisions this Court read an exception into the section in the case of previously executed mortgages. *Thelusson* v. *Smith,* 2 Wheat, 396, 426; *Conrad* v. *Atlantic Insurance Co.,* 1 Pet. 386; *Brent* v. *Bank of Washington,* 10 Pet. 596, 611, 612. This doctrine seems to have been based on the theory that mortgaged property passes to the mortgagee and is no longer a part of the estate of the mortagor. See *Conrad* v. *Atlantic Insurance Co.,* supra, at 441-442. The question of whether the priority of the United States under § 3466 would also be defeated by a specific and perfected lien upon property, whose title remained in the debtor was reserved in those cases.

Ibid; *Brent* v. *Bank of Washington*, supra, at 611-612. . . .'"[2]

That the parties believed there was this doubt is conclusively evidenced by their adoption of the stipulation. In any event, they now rely upon it.

III. But the stipulation is more than an acknowledgment of lien precedence. To repeat, it really amounts to an agreement between the owner and SBA, for the benefit of both the owner and the Bank, that SBA will from its prime position pay the Bank its loan. Accomplishing a complementation between the two loans, it saved the owner from foreclosure and permitted him to borrow from the Government.

Under the stipulation SBA could not appropriate its lien-recovery to its own loan until it had paid the Bank. SBA, of course, intended to press its overtopping lien to the fullest against the mortgage res, and then see that the Bank received its share.

Concededly, SBA was sheltering the Bank under the coverage of the sovereign prerogative. This use of its supremacy in aid of a private lender, however, was entirely within the powers of SBA, unquestionable precedent holds.

While the two loans were not made simultaneously, and so the facts are not identical with those in Small Business Administration v. McClellan, 364 US 446 (1960), still the principles there announced are apposite here. Declaring that SBA could lawfully extend its

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[2] See also W. T. Jones & Co. v. Foodco Realty, Inc., supra 318 F2d 881, 886 (4th Cir. 1963), where this court expressed its doubt whether previously executed mortgages would now prevail over Federal priority asserted under the statute.

priority to protect private lenders, the Court spoke to the point as follows, p. 452:

> "The Small Business Administration is authorized to enter into contracts calculated to induce private banks to make loans to small businesses. The contract involved in this case, by providing additional security to the private bank at the Government's expense, is well adapted to that end. Indeed, in many cases such a contract may be the only way the Administration could induce private Bank participation in a necessary loan."

The Court continued:

> "It is true that the allowance of the priority asserted here will place the bank, a private unsecured creditor, in a better position than other private unsecured creditors. But this position is a result . . . of the bank's valid contract with the Small Business Administration." p. 452-3.

Presently SBA did in effect contract with the Bank in order to save the Bank mortgage from the squeeze of SBA's superior strength. Although not persuading the Bank to make the loan originally, the agreement of SBA did induce the Bank to continue its loan.

The status of the Bank's claim becomes even plainer upon a consideration of the posture of its mortgage after SBA has paid the Bank's loan. The mortgage is not thereby satisfied, but SBA is subrogated to its lien. However, as subrogee it would merely step into the place of the Bank. The mortgage then would be subject to the same defenses as could have been interposed against the Bank if it had remained as the mortagee.

That would be the time and place for the contractor to assert his present claim of priority.

The upshot is that the Bank is entitled to payment by virtue of the agreement with SBA, without reference to State law, and consequently the priority given by the West Virginia statute to a mechanic's lien has no immediate pertinency.

IV. SBA had a untrammelled right to distribute its recovery by payment of a part to the Bank, just as the Court said in *McClellan,* supra, 364 US 446:

> ". . . there is no difference between the money so received and money received from any other source and, like other money, it may be disbursed in any way the Government sees fit, including the satisfaction of obligations already incurred so long as the purpose is lawful." p. 452

The money would come to the Bank unencumbered by any obligation to anyone save the duty to wipe out the debt. Notwithstanding, the Court now subjects this money to the mechanic's lien because State law gives priority to a mechanic's lien over a private mortgage. The infirmity of this contention is that the Bank's receipt did not derive from the enforcement of its lien against the property, but came out of the SBA's priority. The Court's decision violates the policy and agreement of SBA in making its loan. The contractor accepted the benefits of the loan—presumably it was applied to the cost of the construction—and without the stipulation, he would not have received the SBA money.

No equitable considerations dictate capture of the Bank's recovery, as the Court now does, to save the

contractor. He would not have recovered a penny had the Bank not participated in the case at all. The Bank has taken nothing from the contractor. Its claim is not satisfied out of moneys against which the contractor would *otherwise* be entitled. He is not displaced by any act of the Bank.

For its decision the Court reasons that the contractor's priority over the Bank under State law should not be disturbed, *cf.* United States v. New Britain, supra, 347 US 81, 88 (1954), because the contractor would prevail here, if the Federal government were not involved. However appealing it may seem at a glance, this contention ignores the paramount fact that the Federal government *is* involved here, and that its presence *is* attended by the compelling demands of the Federal statute and the policy and needs of the SBA.

In looking for equities to support its conclusion, the Court also muses on what might have been done by the Bank to save itself. It is said that the Bank was the only party which could have protected itself. It cannot be denied that it could have obtained a waiver of the mechanic's lien before advancing the loan moneys. But this comes with poor grace from the contractor as ground for equitable relief; the exaction of a release would have put the pinch on the contractor.

If reveries are to create equities, it is only right to ponder also what the contractor might have done. The contractor could have sought lien subordination from SBA as did the Bank. Had it been refused, the contractor could have treated the procurement of the SBA loan as a breach of the contract by the owner, i.e. impairment of the priority of the contractor's statutory lien. Also, speaking of possibilities open to the

litigants, the contractor could have demanded payments from the owner, at close intervals, to keep the payments current with the labor, materials and profit invested in the job.

Thus the equities in the case are as much with the Bank as with the contractor.

V. The schedule of application of the moneys I suggest is both legally and equitably sound. It accords the Federal claim its complete statutory priority and it enforces the agreement made by SBA for the benefit of the owner and the Bank, all in conformity with the policy of SBA. The mechanic's lien is snuffed out, true, but solely by the statutory priority of SBA and not by the Bank. This hardship has been decried by scholars, but the outcome is rightly blamed on the ancient act of Congress, now 31 USC 191, supra, fn. 1.[3]

I would reverse and distribute the moneys according to the formula first stated herein.

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[3] See, e.g. Note, The Relative Priority of Small Business Administration Liens; An Unreasonable Extension of Federal Preference? 64 Mich. L. Rev. 1007 (1966); Kennedy, The Relative Priority of the Federal Government; The Pernicious Career of the Inchoate and General Line, 63 Yale L. J. 905 (1954).

Statutes Involved

Federal Insolvency Statute, U.S. Rev. Stat. § 3466, U.S.C., Title 31, Section 191, 31 U.S.C.A. § 191:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealing, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

Small Business Act, 15 U.S.C. § 636 (a):

636. **Loans—Restrictions and limitations — State grants.** — (a) The Administration is empowered to make loans to enable small-business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or civilian production or as may be necessary to insure a well-balanced national economy; and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to

participate on an immediate or deferred basis. The foregoing powers shall be subject, however, to the following restrictions and limitations:

(1) No financial assistance shall be extended pursuant to this subsection unless the financial assistance applied for is not otherwise available on reasonable terms.

(2) No immediate participation may be purchased unless it is shown that a deferred participation is not available; and no loan may be made unless it is shown that a participation is not available.

(3) In agreements to participate in loans on a deferred basis under this subsection, such participation by the Administration shall not be in excess of 90 per centum of the balance of the loan outstanding at the time of disbursement.

(4) Except as provided in paragraph (5) [this section], (A) no loan under this subsection shall be made if the total amount outstanding and committed (by participation or otherwise) to the borrower from the revolving fund established by this Act [§§ 631 and notes, 632-647 of this title] would exceed $350,000; (B) the rate of interest for the Administration's share of any such loan shall be no more than 5½ per centum per annum; and (C) no such loan, including renewals or extensions thereof, may be made for a period or periods exceeding ten years except that a loan made for the purpose of constructing facilities may have a maturity of ten years plus such additional period as is estimated may be required to complete such construction.

(5) In the case of any loan made under this subsection to a corporation formed and capitalized by a

group of small business concerns with resources provided by them for the purpose of obtaining for the use of such concerns raw materials, equipment, inventories, supplied or the benefits of research and development, or for establishing facilities for such purpose, (A) the limitation of $350,000 prescribed in paragprah (4) shall not apply, but the limit of such loan shall be $250,000 multiplied by the number of separate small businesses which formed and capitalized such corporation; (B) the rate of interest for the Administration's share of such loan shall be no less than 3 nor more than 5 per centum per annum; and (C) such loan, including renewals and extensions thereof, may not be made for a period or periods exeecdng ten years except that if such loan is made for the purpose of consructing facilities it may have a maturity of twenty years plus such additional time as is required to complete such construction.

(6) The Administrator is authorized to consult with representatives of small-business concerns with a view to encouraging the formation by such concerns of the corporation referred to in paragraph (5) [this section]. No act or omission to act, if requested by the Administrator pursuant to this paragraph, and if found and approved by the Administration as contributing to the needs of small business, shall be construed to be within the prohibitions of the antitrust laws or the Federal Trades Commission Act of the United States. A copy of the statement of any such finding and approval intended to be within the coverage of this section, and any modification or withdrawal thereof, shall be furnished to the Attorney General and the Chairman of the Federal Trade Commission when made, and it shall be published in the Federal Register. The authority granted in this paragraph

shall be exercised only (A) by the Administrator, (B) upon the condition that the Administrator consult with the Attorney General and with the Chairman of the Federal Trade Commission, and (C) upon the condition that the Administrator obtain the approval of the Attorney General before exercising such authority. Upon withdrawal of any request or finding hereunder or upon withdrawal by the Attorney General of his approval granted under the preceding sentence, the provisions of this paragraph shall not apply to any subsequent act or omission to act by reason of such finding or request.

(7) All loans made under this subsection shall be of such sound value or so secured as reasonably to assure repayment.

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IN THE

Supreme Court of The United States

October Term, 1967

No. 1180

HUNTINGTON TRUST & SAVINGS BANK,
a corporation,
Petitioner

vs.

H. B. AGSTEN & SONS, INC.,
a corporation,
BERNARD L. BOUTIN, ADMINISTRATOR,
SMALL BUSINESS ADMINISTRATION, and
ODUS R. KINCAID and DELBERT E. WILLIAMS,
TRUSTEES, WILLIAM H. MEINERS, d.b.a.
GENERAL FLOOR COMPANY,
Respondents.

BRIEF FOR RESPONDENTS H. B. AGSTEN & SONS, INC. and WILLIAM H. MEINERS, d.b.a. GENERAL FLOOR COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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15 U.S.C. §636(a)	3

Cases

Brown v. *General Laundry Service*, 139 Conn. 363, 94 A. 2d 10 (1952)	6
Brown v. *General Laundry Service*, 19 Conn. Supp. 355, 113 A. 2d 601 (1955)	7
Buffalo Savings Bank v. *Victory*, 62-1 U.S.T.C. § 9106 (Supreme Court of N. Y. 1961)	8
Citizens National Bank v. *Harrison-Doddridge Coal Co.*, 89 W. Va. 659, 109 S. E. 892, 894	9
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Hopkins v. *Eureka Coal Company*, 33 Am. Fed. Tax Rep. 1627 (1944)	11
In Re Lieb Bros., Inc., 251 F. 2d 306	10
Martin v. *Kester*, 46 W. Va. 438 33 S. E. 238	9
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United States v. *Texas*, 314 U. S. 480, 484, 62 S. Ct. 350, 354, 86 L. Ed. 356 9

IN THE

Supreme Court of The United States

October Term, 1967

No. 1180

HUNTINGTON TRUST & SAVINGS BANK,
a corporation,
Petitioner

vs.

H. B. AGSTEN & SONS, INC.,
a corporation,
BERNARD L. BOUTIN, ADMINISTRATOR,
SMALL BUSINESS ADMINISTRATION, and
ODUS R. KINCAID and DELBERT E. WILLIAMS,
TRUSTEES, WILLIAM H. MEINERS, d.b.a.
GENERAL FLOOR COMPANY,
Respondents.

BRIEF FOR RESPONDENTS H. B. AGSTEN & SONS, INC. and WILLIAM H. MEINERS, d.b.a. GENERAL FLOOR COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

OPINIONS BELOW

See appendix to Petition pp. 44-64.

JURISDICTION

The jurisdictional requirements are adequately set forth in the Petition.

QUESTIONS PRESENTED

The only question presented is the proper resolution of a circuity of liens problem which arose among the mechanic's lien of the Respondent contractor, H. B. Agsten & Sons, Inc., (which included the lien claim of a supplier William H. Meiners d.b.a. General Floor Company) the trust deed lien of the Petitioner Huntington Trust & Savings Bank and the trust deed lien of the Small Business Administration.

The question was resolved below in accordance with a line of circuity cases involving federal tax liens. The burden of these cases was that the federal government was concerned only with establishing its own priority; that once sufficient money was set aside to insure its priority under federal law allocation of the balance was determined by state law.

More narrowly then the issue is whether this principle is applicable to a circuity problem involving an S.B.A. lien, as the Special Master, District Court and six members of the Court of Appeals concluded, or whether as petitioner contends, the circumstance that the federal lien was held by the Small Business Administration rather than the Internal Revenue Service requires a different solution.

STATUTES INVOLVED

The West Virginia statute which the Court below (speaking through Judge Sobeloff) held controlled the priorities of liens as between Petitioner and Respondent is Section 17, Article 2, Chapter 38 of the official Code of West Virginia of 1931, as amended, which reads as follows:

> "*All of the liens authorized and created by this article shall,* except as provided in section thirty-one of this article, *have priority over any and all other liens created by trust deed or otherwise,* on such building or other structure and improvements appurtenant thereto and on the interest of the owner in the lot of ground whereon the same stands or to which the same may have been removed, *subsequently to the time when such labor shall have begun to be performed, or such material or machinery or other necessary equipment shall have begun to be furnished.*" (our italics)

The two federal statutes cited by Petitioner, R.S. § 3466, 31 U.S.C. § 191 and 15 U.S.C. § 636(a) are not pertinent to the resolution of the question at issue.

STATEMENT

Petitioner's statement is misleading in that it asserts a correlation between the loans of the Bank and the S.B.A. which is substantiated neither by the pleadings nor by the evidence. The Courts below treated them as distinct and competitive, as the record requires.

REASONS WHY CERTIORARI SHOULD BE DENIED

I. The Decision of the Court Below Does Not Hamper the Administration of the Small Business Act.

This case is of importance only to the parties litigant. The decision below turns upon the unique facts of this case and will affect few (if any) other persons in the United States. This is so because few, if any, prudent banks or any other institutions lending money for construction purposes, will be as careless as was Petitioner in failing to obtain waivers of mechanics' liens before advancing construction money after construction has been under way for almost four months.

Petitioner's evident purpose, in its imaginative reconstruction of the record, is to bring the case within the ambit of *S.B.A.* v. *McClellan*, 364 U. S. 446, 81 S. Ct. 191, 5 L. Ed. 2d 200. Had Petitioner assigned its note and deed of trust to the S.B.A., the McClellan case might have some relevance. In the instant case Petitioner's loan and that of S.B.A. were separate and distinct and were so treated by the District Court and the Court of Appeals. Petitioner did not participate in the S.B.A. loan as did the lender in the McClellan case. Nor did Petitioner assign its interest in its loan to the S.B.A. Moreover, there is no evidence in the record that Petitioner's loan was "made in conjunction with the S.B.A. loan" or that it was to be disbursed "concurrently with the S.B.A. loan", or that it was "one of the conditions of said S.B.A. loan". There is nothing in the record to indicate that the S.B.A.

obligated itself to pay off Petitioner's loan. Certainly no such correlation or obligation can reasonably be inferred from the usual and customary second deed of trust language found in the S.B.A.'s trust deed that "this deed of trust and the warranty of title are made subject to and subordinate to . . ." Petitioner's prior deed of trust.

Having no deed of trust or other collateral security the private lender in the McClellan case required other means of securing himself. This was accomplished by a joint participation with the S.B.A., to which he assigned his obligation and who asserted its priority under the Federal Insolvency Statute. 31 U.S.C. 191.

It is useless to speculate what the result in the present case would have been if the S.B.A. had purchased and taken an assignment of the Bank's deed of trust since such was not the case. The S.B.A., in the instant case was, properly, concerned only with its own recovery.

Petitioner's argument that the lower court's decision will handicap the administration of the Small Business Act may be answered by pointing out that those charged with the administration of that Act by Congress apparently don't share the imagined fears of the Petitioner. They have neither appealed from the decision of the District Court nor from the decision of the Circuit Court of Appeals in this case. It may also be answered that by pointing out that the Petitioner as a construction lender could have avoided its problem by doing what any prudent construction lender would have done, i.e. required mechanics' lien

waivers. The administration of the Small Business Act is certainly not handicapped by requiring a construction lender to exercise that prudence a lender should observe were no federal agency involved.

II. The Decision of the Court Below Does Not Involve An Important Question of Federal Law Which This Court Has Never Decided and Which Should Be Decided by This Court.

(a) State not federal law is ultimately determinative in this case.

The court below clearly and succintly stated that the priorities of their respective liens as between the Petitioner and this Respondent were determined by West Virginia law wherein the majority of the Court, speaking through Judge Sobeloff said:

> "In short, while the Bank complains that it is the only party which suffers from this District Court's disposition, the fact is that it '*suffers*' only in the sense that *by the operation of the West Virginia law and not by reason of the Federal Insolvency Statute*, it will regain only about half of its loan." pp 51-52 of Petition. (italics ours)

The case from which all circuity cases subsequent to 1954 have taken their cue is *United States of America* v. *City of New Britain, Connecticut*, 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367, which was an appeal from the Connecticut case of *Brown* v. *General Laundry Service*, 139 Conn. 363, 94 A. 2d 10 (1952).

The Supreme Court reversed the Connecticut Court decision which subordinated federal tax liens not only to mortgages and a judgment, but to water rents and real estate taxes saying:

> "The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. *This is a matter of state law.* But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. There is nothing in the language of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression." (our italics)

On remand the solution indicated by the Supreme Court, and previously utilized by a now much cited Illinois case was followed, and the Connecticut Court required that the amounts as to which the mortgagees and judgment creditor had priority be first applied in inverse order of their own respective priorities to the satisfaction of the local tax and water rent liens. *Brown* v. *General Laundry Service*, 19 Conn. Supp. 355; 113 A. 2d 601 (1955)

The Illinois case, *Samms* v. *Chicago Title & Trust Co.*, 349 Ill. App. 413, 111 N. E. 2d 172 (1953), involved a mortgage of real estate, a mechanic's lien and a federal tax lien. The federal tax lien was afforded priority over the mechanic's lien but the amount of the mechanic's lien was satisfied out of the mortgage.

The court said:

> "It is our conclusion that the claim of the mechanic's lienholder in this case is not within the meaning of Section 3672 and is subordinate to the lien of the government's tax claim. This priority of the government's lien, if only the mechanic's lien were here involved, would be full and complete as to all proceeds derived from the sale of the property resorted to. However, where, as in this case, there is a mortgage which is a lien prior to that of the government's tax claim, then the government for satisfaction of its lien can only resort to those proceeds from the sale of the property which are in excess of the mortgage indebtedness. Therefore, the priority of the government's lien in the instant case is only as to that excess. *The mechanic's lien claimant* by state law is given a lien prior to that of the mortgagee, which in effect means that it *may resort to the proceeds from the sale of the property which are applicable to payment of the mortgage indebtedness.* This is the inevitable result of the application of the Act of Congress and of the state law." (our italics)

So uniformly has this solution been followed by federal and state courts that it might almost be said to have become an established rule of property law.

See: *Southern Ohio Savings Bank & Trust Co.* v. *Bolce* and *Renner* v. *Merriweather*, 165 Ohio St. 201, 135 N. E. 2d 382 (1956); *River Rouge Savings Bank* v. *Victor Building Co.*, 359 Mich. 189, 101 N. W. 2d 260 (1960); *Buffalo Savings Bank* v. *Victory*, 62-1 U.S.T.C. § 9106 (Supreme Court of N. Y., 1961); See also *United States* v. *Buffalo Savings Bank*, 371 U. S. 228, 9 L. Ed. 283, 83 S. Ct. 314.

(b) Construction of Federal Insolvency Statute not fairly raised by case

As early as 1805 this Court, through Chief Justice Marshall, held that the Federal Insolvency Statute did not give debts due the United States priority over prior deeds of trust. *United States* v. *Hooe*, 3 Cranch 73. That this principle has continuing vitality was indicated by this Court at least as recently as 1941. *United States* v. *Texas*, 314 U. S. 480, 484; 62 S. Ct. 350, 354; 86 L. Ed. 356.

Petitioner seeks to cast doubt on these cases by stating that "under West Virginia law a deed of trust does not divest the debtor of title . . . ." This statement is dubious in the light of a long line of decisions in both Virginia and West Virgina. See *Poage* v. *Bell*, 8 Leigh 604 (1837), *Martin* v. *Kester*, 46 W. Va. 438, 33 S. E. 238, and *Citizens National Bank* v. *Harrison-Doddridge Coal Co.*, 89 W. Va. 659, 109 S. E. 892, 894.

However, it is unnecessary to labor the question, for neither the reaffirmation nor the abandonment of the principle that previously executed mortgages defeat the priority of the United States under the Federal Insolvency Statute would be determinative in the present case. It could only be *obiter dicta*. The circuity problem would exist, regardless of whether the Petitioner's lien is prior to that of the S.B.A. because of a judicially created exception to the Federal Insolvency Statute or because of a purported agreement to subordinate the S.B.A.'s deed of trust. The reason for Petitioner's priority is immaterial.

In either event, as in the previously and hereinafter cited circuity cases, an orderly sequence of priorities provided by state law was interfered with by the interjection of a federal statute giving a federal lien priority over a local lien which under state law would have had first priority. A circuity problem was injected only by the creation of an additional lien admittedly superior in priority to the federal lien but inferior to the first local lien.

In the present case, the circuity problem is created because the Federal Insolvency Statute admittedly gives the Small Business Administration's deed of trust priority over this Respondent's mechanic's lien and it can make no difference to its solution why the Bank's deed of trust is superior to the S.B.A.'s.

III. The Decision Is Consistent with Those of Other Federal Courts.

As pointed out by Judge Sobeloff (pp. 48-50 of Petition) the Fourth Circuit in approving the Special Master's resolution of the circuity problem was merely following the "federal policy" in this area already applied by the Third Circuit in *In Re Lieb Bros., Inc.*, 251 F. 2d 306, by the Fifth Circuit in *Exchange Bank & Trust Co.* v. *Tubb Manufacturing Co.*, 246 F. 2d 141, a case involving the Federal Insolvency Statute, and by a First Circuit District Court, in *United States* v. *Lord*, 155 F. Supp. 105 (D.N.H. 1957). There is no contrary federal authority.

IV. The Decision Is Consistent with Applicable State Law.

The decision below gives effect to the unequivocal language of the pertinent West Virginia statute Section 17, Article 2, Chapter 38 previously cited giving this Respondent a lien superior to the Petitioner's trust deed.

It is consistent with the only West Virginia authority on the circuity subject, a decision of the Circuit Court of Kanawha County. This case, *Hopkins* v. *Eureka Coal Company*, 33 Am. Fed. Tax Rep. 1627 (1944) another case involving the Federal Insolvency Statute, required determination of the respective priorities of a federal tax lien, a mortgage, a trust deed and tax liens of the State of West Virginia. Finding the mortgage and trust deed superior to the federal tax lien and the federal tax lien superior to those of the State, the Court then found that from the amounts paid the holders of the mortgage and trust deed must be paid the liens of the State, those being superior to the mortgage and trust deed.

V. The Decision of the Court of Appeals Is Plainly Right.

Petitioner has been paid $205,456.44 from the sale of the motel, the Respondent contractor has been paid $228,698.47, and the balance of the $700,000.00, after costs and minor claims, is credited to the S.B.A.'s purchase price.

Under Petitioner's proposed solution the contractor's $228,698.47 would be taken from him and given

to Petitioner. The contractor would receive nothing from the $700,000.00 realized from the sale.

In sum Petitioners asks a resolution of the circuity problem that will require Respondent to bear the entire burden of Petitioner's careless lending practices, and will penalize Petitioner not at all.

CONCLUSION

For the foreging reasons it is respectfully submitted that the petition for certiorari should be denied.

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H. B. Agsten & Sons, Inc. and William H. Meiners, d.b.a. General Floor Company

March 25, 1968

CERTIFICATE OF SERVICE

The undersigned counsel for the Respondents H. B. Agsten & Sons, Inc. and William H. Meiners, d.b.a General Floor Company does hereby certify that on the 27 day of March, 1968, I served copies of the foregoing brief on the Petitioner and other Respondents in this action in accordance with Paragraphs 1 and 2(a)

of Rule 33, Revised Rules of the Supreme Court of the United States, as follows:

Upon Petitioner, Huntington Trust & Savings Bank, a corporation, by depositing the same in a United States Post Office with first class postage pre-paid, addressed to its counsel of record, David M. Baker, Edward H. Greene and Lawrence L. Pauley, 419 Eleventh Street, Huntington, West Virginia 25701.

Upon respondents, Bernard L. Boutin, Administrator, Small Business Administration, and Odus R. Kincaid and Delbert E. Williams, Trustees, by depositing the same in a United States Post Office with first class air mail postage pre-paid, addressed to their counsel of record, Morton Hollander and John C. Eldridge, Attorneys, Department of Justice, Washington, D. C. 20530, and in addition, by depositing a copy thereof in a United States Post Office with first class air mail postage pre-paid, addressed to Solicitor General, Department of Justice, Washington, D. C. 20530.

Howard R. Klostermeyer

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SUPREME COURT, U. S.

No. 1130

APR 3 1968

JOHN F. DAVIS, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1967

HUNTINGTON TRUST & SAVINGS BANK,
A CORPORATION, PETITIONER

v.

H. B. AGSTEN & SONS, INC., ROBERT MOOT, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, and ODUS R. KINCAID and DELBERT E. WILLIAMS, TRUSTEES, WILLIAM H. MEINERS, d.b.a. GENERAL FLOOR COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR SMALL BUSINESS ADMINISTRATOR AND TRUSTEES IN OPPOSITION

ERWIN N. GRISWOLD,
Solicitor General,

EDWIN L. WEISL, JR.,
Assistant Attorney General,

JOHN C. ELDRIDGE,
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Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1180

HUNTINGTON TRUST & SAVINGS BANK,
A CORPORATION, PETITIONER

v.

H. B. AGSTEN & SONS, INC., ROBERT MOOT,[1] ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, and ODUS R. KINCAID and DELBERT E. WILLIAMS, TRUSTEES, WILLIAM H. MEINERS, d.b.a. GENERAL FLOOR COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR SMALL BUSINESS ADMINISTRATOR AND TRUSTEES IN OPPOSITION

OPINIONS BELOW

The *en banc* opinion of the court of appeals (Pet. App. 44-64) is not yet reported. The district court,

[1] Robert Moot has succeeded Bernard L. Boutin as Administrator of the SBA.

without opinion, adopted the Report of the Special Master (Pet. App. 13-43).

JURISDICTION

The judgment of the court of appeals was entered on December 4, 1967. The petition for certiorari was filed on March 1, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court below properly determined that, when federal and state statutes provide different orders of priority in case of insolvency, the state priorities should be applied to the distribution of any funds to which the federal priority does not attach.

STATEMENT

This is an insolvency proceeding in which three secured liens more than exhaust the proceeds of a judicial sale. The only disputed question concerns the order of their priority *inter sese*.

In mid-1964, H. B. Agsten & Sons, Inc. (Agsten) began construction of a motel for West Virginia Industries Development Corporation. Prior to that time, West Virginia Industries had obtained an authorization and commitment for a loan from the Small Business Administration (SBA) in the amount of $1,042,500.00. That authorization required West Virginia Industries to obtain a loan of $400,000.00 from a nongovernment lender. Nearly four months after the start of construction, West Virginia Industries ob-

tained a $400,000.00 loan from petitioner which was secured by a deed of trust covering the property involved. Shortly thereafter, the SBA loan was consummated. That loan was secured by a second deed of trust which stated that it was subordinate to the earlier deed of trust held by petitioner.

By the time of the completion of the motel in mid-1965, West Virginia Industries was insolvent. Agsten then filed a notice of mechanic's lien for $217,098.33, and brought this suit to enforce its lien.

All parties agreed that, by virtue of state law, W. Va. Code (Michie Ed.) 38-2-1, 38-2-17, the contractor's lien held by Agsten is superior to the mortgage lien of petitioner; that, by virtue of the respective mortgage instruments, the lien of petitioner is superior to that of the SBA; and that, by virtue of R.S. 3466, 31 U.S.C. 191, the lien of SBA is superior to that of Agsten. The only question in dispute is how to resolve the problem of circuity of priority created by the conflicting federal and state priority statutes.

The special master and the district court determined that the amount of petitioner's lien would be first set aside as prior to that of SBA, but that state law would require that Agsten's lien be satisfied in full out of that amount before the remainder was paid to petitioner. Then the lien of SBA would be satisfied, followed by the remainder of petitioner's lien.[2]

The court of appeals, *en banc*, affimed the district court. The court held that, when a circuity problem

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[2] The sale did not produce enough money to completely satisfy SBA's lien under this theory of distribution.

arises because of conflicting state and federal priorities, the uniform decisions of lower courts and the decision of this Court in *United States* v. *New Britain*, 347 U.S. 81, 87-88, require that federal law first be applied. Federal law, it held, however, required only that, after the payment of the $400,000 to which SBA was subordinated, SBA should be recompensed for its loan to the extent possible. But the ultimate disposition of the $400,000 was held to be purely a matter of state concern. Since state law gave priority to contractors' liens, Agsten would be paid out of that amount before petitioner. Thus, the court found, that disposition "satisfactorily accommodates the competing interests of state and federal law * * *" (Pet. App. 45).

ARGUMENT

The decision below, which is in accord with the decision of this Court in *United States* v. *New Britain*, 347 U.S. 81, 87-88, and the uniform decisions of lower courts, does not warrant further review by this Court.

1. The question here is whether petitioner can somehow take advantage of the priority enjoyed by the United States under federal law in order to exclude the contractor, whose priority over petitioner flows from the provisions of state law.

The priority of the SBA is created by the terms of R.S. 3466, the insolvency statute, 31 U.S.C. 191.[3]

[3] In addition, under Federal law, the lien of SBA would be superior to that of Agsten even if there were no insolvency, since Agsten's lien was not "choate" at the time that of SBA attached, and thus would be inferior thereto under the "first

That statute commands that, if the debtor is insolvent, the debts due the United States "shall be first satisfied". Cf. *United States* v. *Vermont*, 377 U.S. 351. The sole recognized exception to that statute has been for previously executed mortgages, see, *e.g.*, *United States* v. *Texas*, 340 U.S. 480, 484.[4] SBA, in accordance with the recognition of an exception for previously executed mortgages, provided in its deed of trust that it would be subordinate to the lien of petitioner's mortgage.

Petitioner asserts (Pet. 8-10) that since SBA holds a second deed of trust which is expressly subordinate to petitioner's first deed the SBA's priority under R.S. 3466 should be extended to petitioner under the holding in *SBA* v. *McClellan*, 364 U.S. 446. This argument would seem to postulate that SBA's agreement with West Virginia Industries to accept a second

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in time, first in right" doctrine. *United States* v. *Colotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15.

[4] It has been frequently argued that an additional exception exists for specific and perfected liens. This Court, while reserving the question of whether such an additional exception exists, has held that if it did exist, it would apply only when the lien is so "perfected and specific" that title or possession would be viewed as passing to the holder of the lien. See, *e.g.*, *United States* v. *Gilbert Associates*, 345 U.S. 361, 365-366; *United States* v. *Waddill Co.*, 323 U.S. 353, 355; *Illinois* v. *Campbell*, 329 U.S. 362, 370. Petitioner errs in contending (Pet. 6-8) that this case presents the question so far reserved by this Court. Since petitioner's mortgage is already conceded to defeat the R.S. 3466 priority under federal law, the issue of whether petitioner's mortgage lien is sufficiently "specific and perfected" to defeat SBA's R.S. 3466 priority could not possibly enter this case.

mortgage constituted some kind of joint venture arrangement with petitioner, with an agreement to extend the government's priority to petitioner.

However, nothing in *McClellan* supports such a proposition. In that case the SBA had made a joint loan with a private bank—the SBA furnished three-fourths of the funds and the private bank the remainder. After bankruptcy was filed against the borrower, the SBA filed a claim for the full amount due on the loan but asserted its priority only as to three-fourths of the entire amount. In these circumstances, this Court held that the SBA did not forfeit its priority by agreeing to share its recovery with the private bank. However, the Court's decision rested on the fact that the priority was being asserted only as to the amount due the SBA and, therefore, the other creditors had no standing to complain about how SBA chose to dispose of the funds to which it was legally entitled. The situation here is entirely different, for petitioner is contending that the amount of SBA's priority should be increased to include not only the amount loaned by SBA but also the amount of petitioner's mortgage. As the court of appeals noted (Pet. App. 54), there is absolutely no support here for the notion that SBA ever agreed to extend the government's priority to petitioner or that it entered any kind of joint venture.

2. Petitioner also contends (Pet. 12) for a theory which would apply state law first, then federal law. Thus, under West Virginia law, Agsten would come first and petitioner would follow. However, SBA's claim would be given precedence over all claims that

could not withstand the application of R.S. 3466. Thus, petitioner contends that while in theory Agsten would be given first priority under state law, he would not be entitled to any actual payment because SBA's claim, which has priority under federal law, would exhaust all available funds. However, petitioner would be allowed to recover in full because its claim would have priority over that of SBA. Thus, R.S. 3466 would be used to provide petitioner—which, as the court below noted (Pet. 50-52), was the only party which could have completely protected itself from Agsten's lien when making the loan—with a complete priority over Agsten. The Federal Insolvency Statute, however, was not intended to regulate the priorities of non-federal liens *inter sese*, and this theory would destroy the priority policy of West Virginia which accords Agsten priority over petitioner. As the Fourth Circuit properly held, that theory "offends the West Virginia lien statutes * * *; the Federal Insolvency Statute * * *; and our sense of equity * * *" (Pet. App. 51).

In *United States* v. *New Britain*, 347 U.S. 81, 87-88, this Court faced a similar circuity problem arising out of competing state and federal priorities. In *New Britain*, federal liens were, under federal law, superior to certain municipal liens but inferior to mortgage and judgment[5] liens. Under state law, however, the municipal liens were superior to the mortgage and judgment liens. The state court initially

[5] The priority of the United States under the insolvency statute did not apply, since the record did not show insolvency. Id. at 85.

placed the United States last in priority, reasoning that since the federal liens were inferior to the mortgage and judgment liens and the mortgage and judgment liens were inferior to the municipal liens, Congress must have intended the federal liens to be inferior to the municipal liens. *Brown* v. *General Laundry Service*, 139 Conn. 363, 94 A.2d 10, 15. This Court reversed, holding that:

> The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. * * *

United States v. *New Britain*, 347 U.S. 81, 88. Upon remand, the state court resolved the circuity problems in the same manner as the courts below. *Brown* v. *General Laundry Service*, 19 Conn. Sup. 335, 113 A. 2d 601, 604. Since federal law demands only that the federal liens be satisfied after a sum equal to petitioner's claim is paid out, there is no reason to bar the state from allocating priorities as to liens wholly governed by state law with respect to the sum to which the federal priority does not attach. That is the approach uniformly taken by the lower federal courts. See, *e.g.*, *Exchange Bank & Trust Co.* v. *Tubbs Manufacturing Co.*, 246 F. 2d 141, 144 (C.A. 5); *In re Lieb Bros. Inc.*, 251 F. 2d 305 (C.A. 3); *United States* v. *Lord*, 155 F. Supp. 105, 110 (D. N.H.); *Smith* v. *United States*, 113 F. Supp. 702, 711-712 (D. Haw.). See also *Samms* v. *Chicago Title & Trust Co.*, 349 Ill.

App. 413, 111 N.E. 2d 172, 176-177; *Southern Ohio Sav. Bank & Trust Co.* v. *Bolce*, 165 Ohio St. 201, 135 N.E. 2d 382, 391.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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